

ALASKA LEGISLATURE COMMITTEE FILES 1981-1982 8672

2026 HSA HB 770 (FILE #1 - #2)

2026

STATE OF ALASKA
GENERAL AND SEGREGATED STATE PROGRAM FUNDS
DEBT CERTIFICATES-- CREDIT UNIONS

January 31, 1982

<u>Description</u>	<u>Balance</u>	<u>Yield</u>
Alaska District Engineers FCU	\$ 960,000.00	
Alaska Feminist FCU	124,000.00	
A. L. P. FCU	975,000.00	
Alaska Municipal Employees FCU	1,840,000.00	
Alaska Railroad FCU	1,290,000.00	
Alaska School Employees FCU	3,530,000.00	
Alaska State Employees FCU	975,000.00	
Alaska Teamsters FCU	2,090,000.00	
Alaska U. S. A. FCU	19,860,000.00	
Bering Straits FCU	45,000.00	
Eielson Employees FCU	1,515,000.00	
Fed Alaska FCU	3,600,000.00	
Fort Wainwright FCU	1,165,000.00	
KPC Employees FCU	681,000.00	
Matanuska Valley FCU	1,230,000.00	
North Country FCU	313,000.00	
Northern School FCU	930,000.00	
R. A. A. FCU	694,000.00	
Skagway FCU	44,000.00	
Starliner FCU	293,000.00	
Tlingit & Haida FCU	478,000.00	
Tongas FCU	671,000.00	
Union Collier FCU	406,000.00	
Western Alaska Trades FCU	770,000.00	
Wein Employees FCU	700,000.00	
	<u>\$45,179,000.00</u>	
TOTAL		<u>8.85</u>

CHANGE IN PORTFOLIO COMPOSITION

	<u>Current Month</u>	<u>Year-to-Date</u>
<u>OPERATING ACCOUNT</u>		
<u>Net Contribution (to) From:</u>		
Taxes and Other Receipts	45,221,922.17	912,169,657.52
Loan and Mortgage Programs	4,669,465.51	52,123,753.57
Separately Invested Funds	(1,400,250.00)	(4,610,618.06)
Certificates of Deposit/Debt	4,595,099.40	7,099,635.56
State Operating Expenditures	(48,328,708.13)	(899,801,041.44)
Retirement Funds	(8,385,106.68)	(69,721,633.84)
Bank Accounts	-0-	20,469.60
	<u>\$ (3,627,577.73)</u>	<u>\$ (2,719,777.09)</u>

General and Segregated State Program Funds

CHANGE IN PORTFOLIO COMPOSITION - Continued

	<u>Current Month</u>	<u>Year-to-Date</u>
<u>MARKETABLE SECURITIES ACCOUNT</u>		
<u>During the Month Funds were Provided by:</u>		
Portfolio Operations:		
Interest Income	\$ 4,173,277.38	\$ 130,519,387.39
Net Gain (Loss) on Sale/Maturity of Securities	-0-	-0-
Total Provided by Operations	<u>4,173,277.38</u>	<u>130,519,387.39</u>
Sale of Marketable Securities	-0-	741,604,845.04
Maturity of Marketable Securities	156,958,553.68	2,485,977,995.37
Taxes and Other Receipts	266,642,205.38	1,740,194,330.16
Other Interest Earnings	-0-	3,030.24
Permanent Fund Income Transferred to General Fund	<u>-0-</u>	<u>931,481.21</u>
TOTAL Funds Provided During the Month	<u>427,774,036.44</u>	<u>5,099,231,069.41</u>
<u>During the Month Funds were Used for:</u>		
Purchase of Marketable Securities	265,597,529.19	2,850,065,852.57
Contribution to Power Development Fund	25,000,000.00	200,000,000.00
State Operating Expenditures	<u>151,000,000.00</u>	<u>2,013,600,000.00</u>
TOTAL Funds Used During the Month	<u>441,597,529.19</u>	<u>5,063,665,852.57</u>
NET CHANGE IN FUNDS	<u><u>\$(13,823,492.75)</u></u>	<u><u>\$ 35,565,216.84</u></u>
<u>LOAN AND MORTGAGE PROGRAMS</u>		
<u>During the Month Funds were Provided by:</u>		
Interest Income	\$ 2,342,400.71	\$ 15,934,426.90
Principal Repayments	2,327,064.80	34,207,384.67
Redemption of Certificates of Deposit	-0-	26,400,000.00
Net Contribution from Operating Account	<u>-0-</u>	<u>-0-</u>
TOTAL Funds Provided During the Month	<u>4,669,465.51</u>	<u>76,541,811.57</u>
<u>During the Month Funds were Used for:</u>		
Purchase of:		
Loans and Mortgages	-0-	1,168,058.00
Certificates of Deposit	<u>-0-</u>	<u>23,250,000.00</u>
Total Purchases	<u>-0-</u>	<u>24,418,058.00</u>
Net Contribution to Operating Account	<u>4,669,465.51</u>	<u>52,123,753.57</u>
TOTAL Funds Used During the Month	<u>4,669,465.51</u>	<u>76,541,811.57</u>
NET CHANGE IN FUNDS	<u><u>-0-</u></u>	<u><u>-0-</u></u>

General and Segregated State Program Funds

CHANGE IN PORTFOLIO COMPOSITION - Continued

	<u>Current Month</u>	<u>Year-to-Date</u>
<u>SEPARATELY INVESTED FUNDS</u>		
<u>During the Month Funds were Provided by:</u>		
Portfolio Operations:		
Interest Income	296,680.45	3,336,437.22
Net Gain (Loss) on Sale of Securities	-0-	937.50
Total Provided by Operations	<u>296,680.45</u>	<u>3,337,374.72</u>
Sale/Maturity of Marketable Securities	4,946,828.95	29,477,432.05
Net Contribution from Marketable Securities Account	25,000,000.00	200,000,000.00
Net Contribution from Operating Account	<u>1,400,250.00</u>	<u>5,069,280.56</u>
TOTAL Funds Provided During the Month	<u>31,643,759.40</u>	<u>237,884,087.33</u>
<u>During the Month Funds were Used for:</u>		
Purchase of Marketable Securities	31,539,220.52	236,594,848.20
Net Contribution to Operating Account	<u>-0-</u>	<u>458,662.50</u>
TOTAL Funds Used During the Month	<u>31,539,220.52</u>	<u>237,053,510.70</u>
NET CHANGE IN FUNDS	<u>\$ 104,538.88</u>	<u>\$ 830,576.63</u>
<u>CERTIFICATES OF DEPOSIT/DEBT CERTIFICATES</u>		
<u>During the Month Funds were Provided by:</u>		
Interest Income	\$ 2,595,099.40	\$ 7,751,301.39
Redemption of Deposit/Savings Certificates	29,500,000.00	80,637,244.86
Net Contribution from Operating Account	<u>-0-</u>	<u>7,729,252.21</u>
TOTAL Funds Provided During the Month	<u>32,095,099.40</u>	<u>86,117,798.46</u>
<u>During the Month Funds were Used for:</u>		
Purchase of Deposit/Savings Certificates	27,500,000.00	81,288,910.69
Purchase of Debt Certificates	-0-	-0-
Net Contribution to Operating Account	<u>4,595,099.40</u>	<u>14,828,887.77</u>
TOTAL Funds Used During the Month	<u>32,095,099.40</u>	<u>96,117,798.46</u>
NET CHANGE IN FUNDS	<u>\$ -0-</u>	<u>-0-</u>
<u>BANK ACCOUNTS</u>		
Interest from Bank Accounts	\$ -0-	\$ 20,469.60
Net Contribution to Operating Account	<u>-0-</u>	<u>20,469.60</u>
NET CHANGE IN FUNDS	<u>\$ -0-</u>	<u>\$ -0-</u>

General and Segregated State Program Funds

CHANGE IN PORTFOLIO COMPOSITION - Continued

	<u>Current Month</u>	<u>Year-to-Date</u>
<u>SUMMARY OF CHANGES</u>		
Operating Account	\$ (3,627,577.73)	\$(2,719,777.09)
Marketable Securities Account	(13,823,492.75)	35,565,216.84
Loan and Mortgage Programs	-0-	-0-
Separately Invested Funds	104,538.88	830,576.63
Certificates of Deposit/Debt	-0-	-0-
Bank Accounts	-0-	-0-
	<hr/>	<hr/>
NET CHANGE IN FUNDS	<u>\$(17,346,531.60)</u>	<u>\$33,676,016.38</u>

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THE CASE FOR INTERNATIONAL DIVERSIFICATION

International diversification of an investment portfolio can provide four benefits: reduction in the volatility of the portfolio; an increase in the return; an increase in the marketability of the portfolio as a whole; and protection against an unexpectedly high rate of inflation in the United States.

1. Protection from Inflation

Diversification into markets of different countries with different economic cycles and different rates of inflation reduces the risk that an entire portfolio will show a low real rate of return. The return of the international element of the portfolio will not be impaired by an unexpectedly high level of inflation in the United States. Indeed it will tend to benefit since the growth of the inflation differential is likely to be reflected in exchange rates so that overseas holdings will rise in terms of the United States dollar. A rise in the exchange rate of the United States dollar might lead, on the other hand, to the returns on overseas investments not matching those on United States investments. Any fall in the United States rate of inflation would, however, be highly beneficial to the performance of United States investments. Since the proportion invested in overseas markets would likely be relatively small, the overall performance of a portfolio with 90 per cent invested in the United States and 10 per cent in overseas markets would still be quite satisfactory during this period of low domestic inflation. International diversification protects the assets of a fund in that it provides a higher return on overseas securities at the time it is most needed - when the rate of domestic inflation is unexpectedly high.

2. Reduced Volatility

The prices of different shares in any one market tend to move fairly closely together, but the correlation between share price movements in different markets is low.

Correlation coefficients between United States and Foreign Stock Markets 1970-1979.

United States	1.00
United Kingdom	.54
Japan	.52
Germany	.51
France	.48
Hong Kong	.45

One study has indicated that the reduction in volatility for the period 1959 to 1979 for a portfolio with 90 per cent invested in the Standard & Poor's Composite Index and 10 per cent equally divided among the equity markets of France, Germany, Japan, and the United Kingdom (as represented by the Capital International Index for each of these markets) from the volatility of a portfolio invested wholly in the Standard & Poor's Composite Index would have been nearly half that which would have been obtained by holding 10 per cent of the portfolio in cash equivalents. International diversification thus leads to a substantial reduction in volatility.

3. Greater Return

The rate of return in the years 1959 to 1979 was generally greater in the major markets outside North America than in the United States. A study made by InterSec Research Corporation shows the rates of return achieved by investment in the Capital International Indices of the markets of Canada, France, Germany, Japan, and the United Kingdom and in the Standard & Poor's Composite Index in the United States over four periods (1959 to 1979, 1965 to 1979, 1970 to 1979, and 1974 to 1979), after taking account of dividend yield and adjusting for fluctuations in exchange rates. The returns in every period were higher in each of the overseas markets than in the United States except in the case of the French market in the longest period. The rate of return of a portfolio divided equally among the four markets outside North America would have been higher by about 70 per cent in the first period, 150 per cent in the second period, 160 per cent in the third period and 85 per cent in the final period. The investment of even a small proportion of a United States portfolio in international markets would, therefore, have resulted in a significant increase in the return of the whole portfolio.

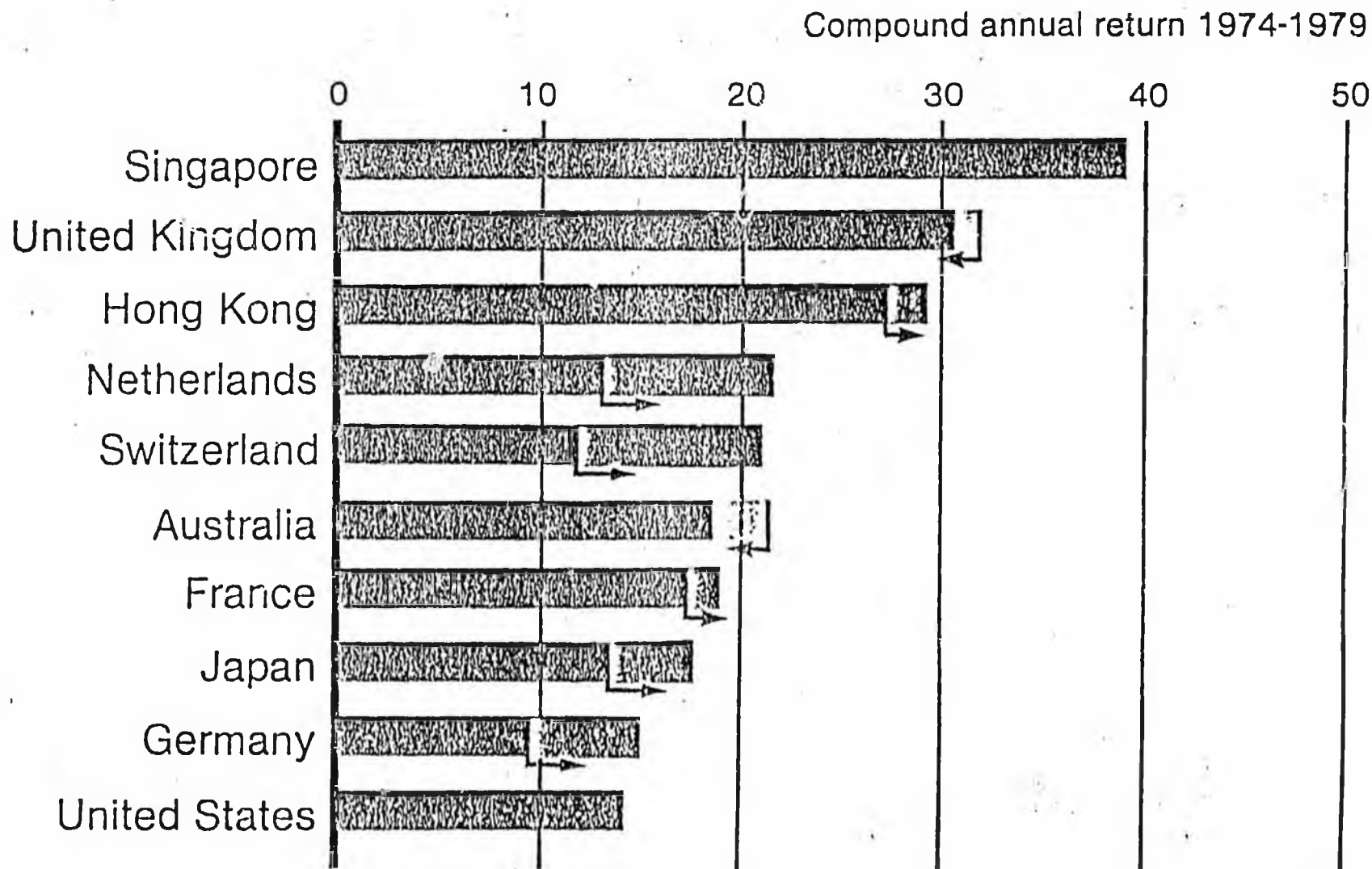
4. Increased Marketability

Capital International has published figures for turnover in 1979 in 14 stock markets in Europe and the Far East. Turnover in these 14 markets amounted to \$220.7 billion, over 86 per cent of the turnover of the United States and Canadian equity markets in the same year. Capital International has also published figures for the market capitalization of equities on 16 stock exchanges outside North America. At the end of 1979 the total amounted to \$755 billion, almost 71 per cent of the combined market capitalizations of the United States and Canadian stock markets at that time. The size of markets outside North America is thus considerable, and turnover forms a larger proportion of market capitalization in them, taken as a whole, than in North America. Moreover, there were 127 companies listed on these 16 markets outside North America with a market capitalization which was greater than that of the 200th largest listed United States company at the end of 1979. There is thus considerable opportunity for large scale investment in markets outside the United States and Canada.

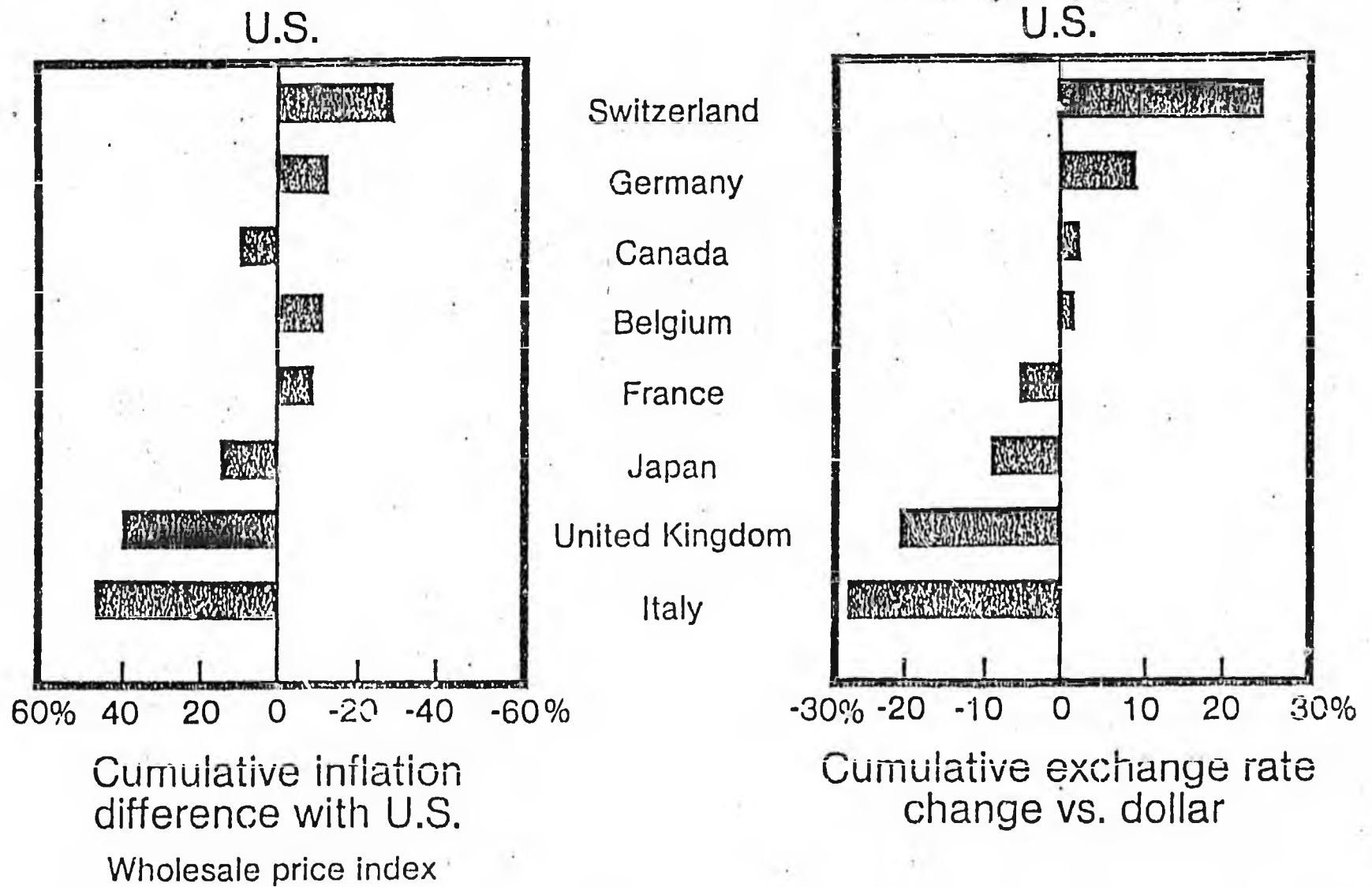
5. Investment in International Bond Markets

The total capitalization of the Eurobond market and the nine national bond markets of Australia, Denmark, France, Germany, Japan, the Netherlands, Sweden, Switzerland, and the United Kingdom at the end of 1979 was about \$1,414 billion. By comparison, the taxable bond market in the United States had an estimated capitalization of about \$1,400 billion and that of Canada a capitalization of about \$105 billion. The large size of international bond markets provides United States investors with a further means of benefiting from international diversification, but with a lower degree of volatility than that involved in equity investment.

Some return comes from currency exchange rate changes.

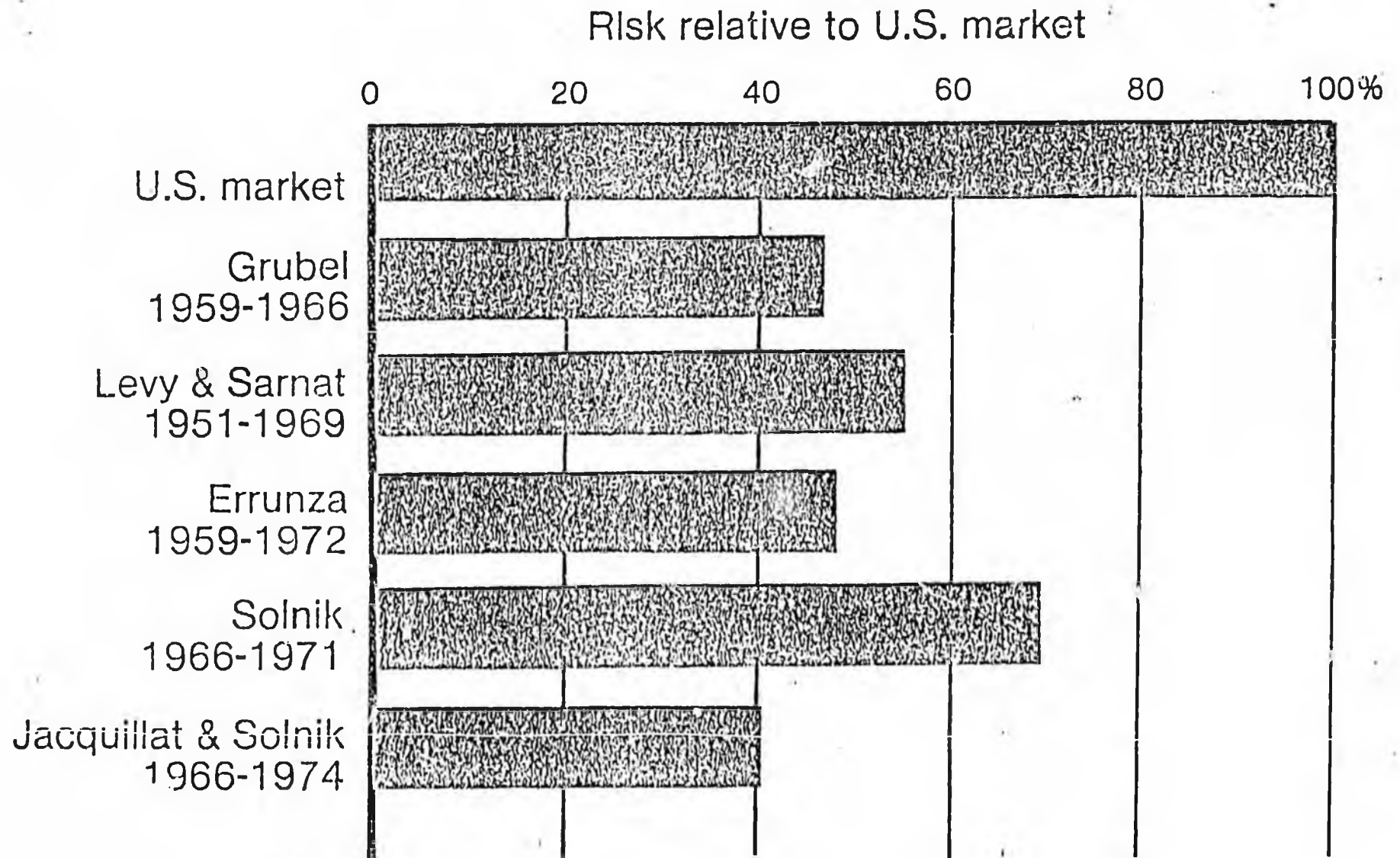


Currency exchange rates (longer term) depend on differences in inflation rates.

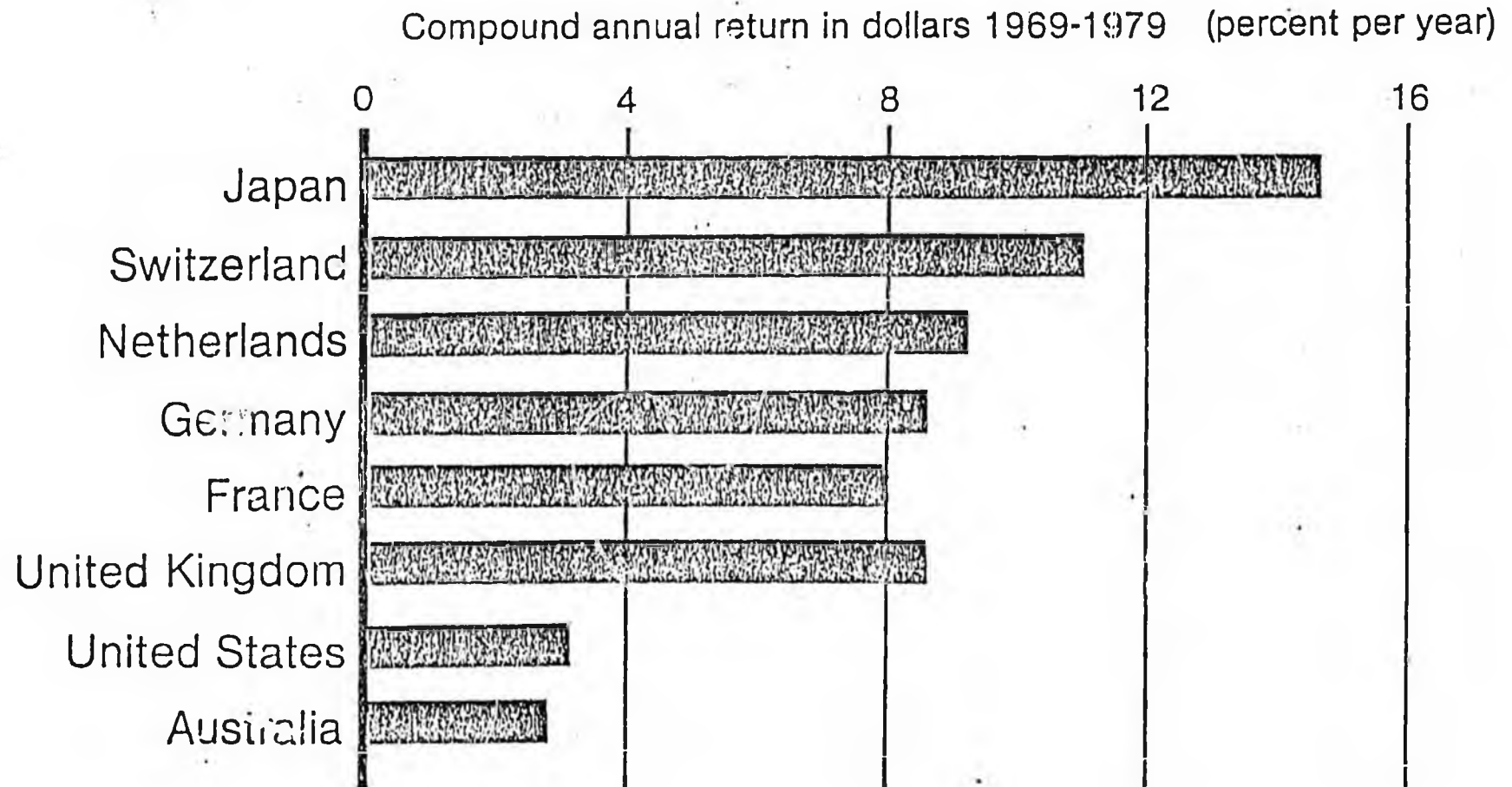


Source: Kemp Period: March 1973-December 1976

Studies show that international diversification reduces risk substantially.

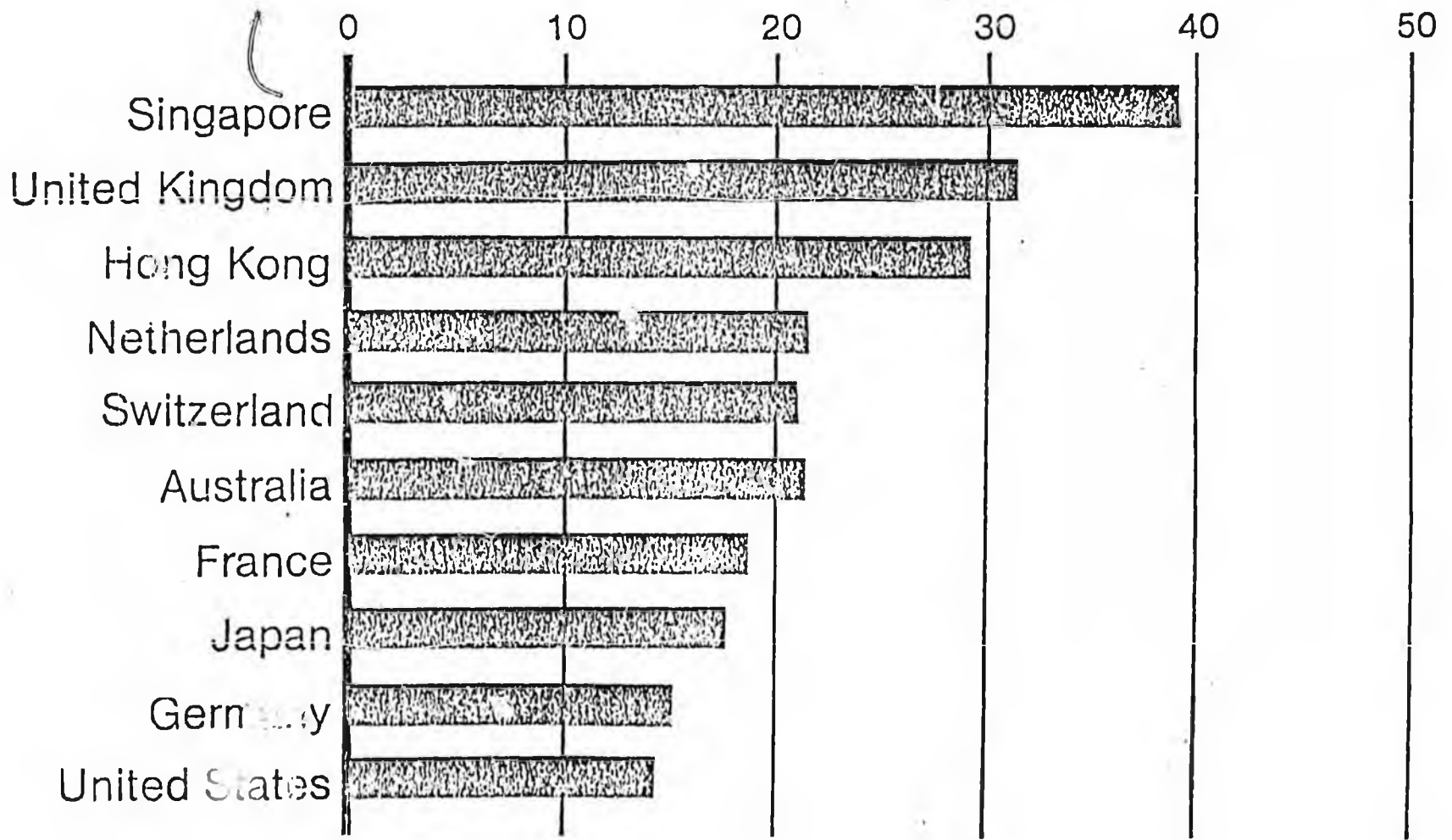


Foreign markets have shown better returns than the U.S. market for the past ten years.

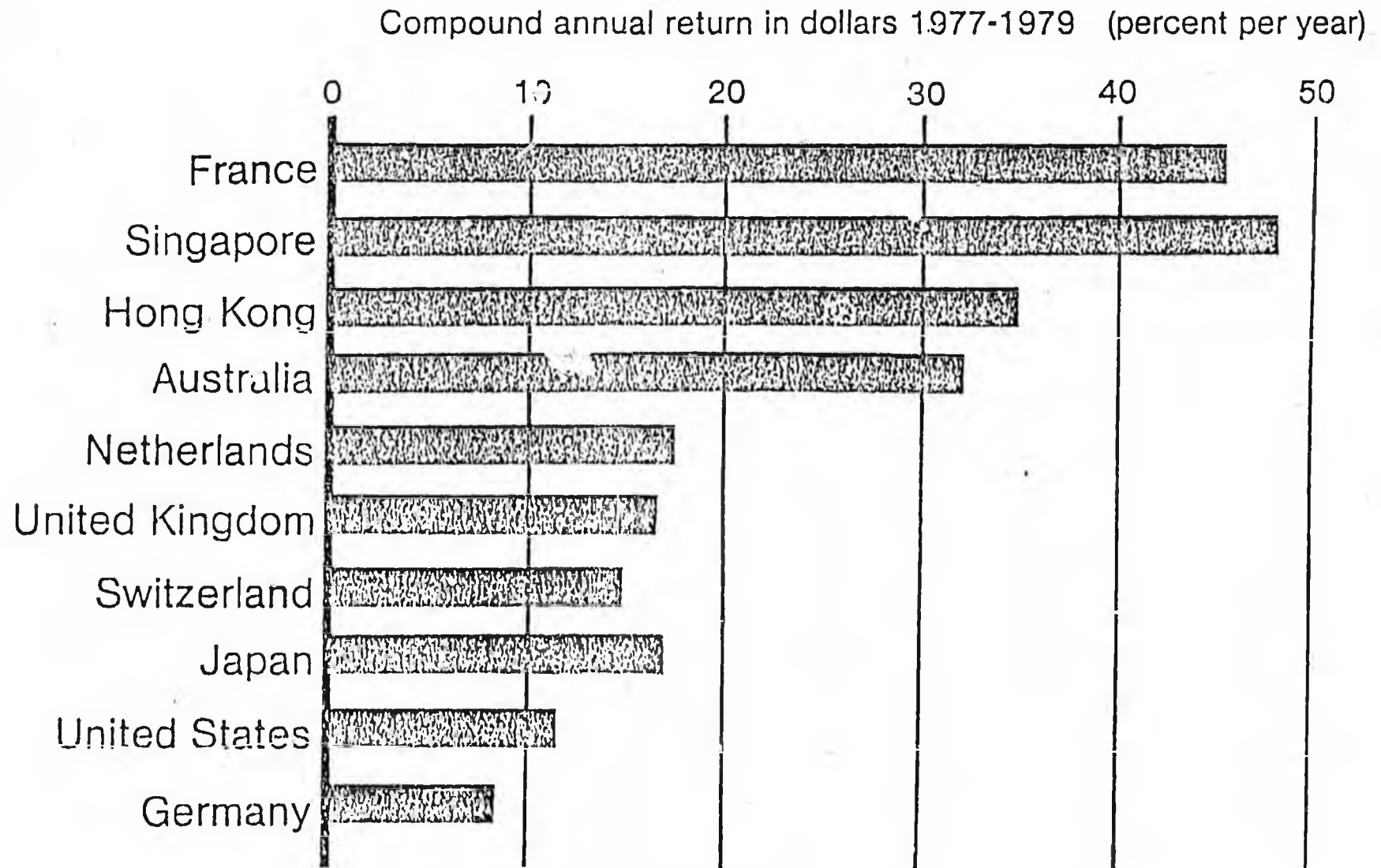


Foreign markets have shown better returns than the U.S. market for the past five years.

Compound annual return in dollars 1974-1979 (percent per year)



Foreign markets have shown better returns than the U.S. market for the past two years.





TOTAL RETURNS ON INVESTMENT FROM MAJOR WORLD STOCK MARKETS
BEFORE AND AFTER U.S. INFLATION FOR THE FIVE YEARS 1974-'78+

	TOTAL RETURNS LOCAL CURRENCY	TOTAL RETURNS U.S. \$ TERMS	INFLATION in U.S.	TOTAL RETURNS AFTER U.S. INFLATION
U.S.	4.29	4.29	7.94	-3.38
Japan	9.48	17.72		-9.06
U.K.	14.54	11.61		3.40
Germany	11.85	21.04		12.14
France	6.70	10.13		2.03
Switzerland	1.37	16.84		8.25
Australia	9.92	4.44		-3.24
Canada	5.40	1.93		-5.57
EAFE*		12.11		3.86

*Europe, Australia, Far East Indices of sixteen markets, weighted according to their size. Prepared by Capital International, Geneva.
+ percent per annum, compounded.



INTERSEC RESEARCH CORP.
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for Pension Managers

TOTAL RETURNS ON INVESTMENT FROM MAJOR WORLD STOCK MARKETS
BEFORE AND AFTER U.S. INFLATION FOR THE THREE YEARS 1976-'78+

	TOTAL RETURNS LOCAL CURRENCY	TOTAL RETURNS U.S. \$ TERMS	INFLATION in U.S.	TOTAL RETURNS AFTER U.S. INFLATION
U.S.	6.92	6.92	6.86	.06
Japan	24.49	30.73		22.33
U K.	17.12	17.42		9.88
Germany	3.82	19.49		11.82
France	10.28	12.93		5.68
Switzerland	2.34	20.76		13.00
Australia	10.31	7.16		0.28
Canada	14.77	9.13		2.12
EAFE*		18.39		10.79

*Europe, Australia, Far East Indices of sixteen markets, weighted according to their size. Prepared by Capital International, Geneva.
+ percent per annum, compounded.

250

225

200

175

150

125

100

75

50

MORGAN GUARANTY INTERNATIONAL EQUITIES FUND
COMPARATIVE PERFORMANCE-JAN. 1974 = 100 : DIVIDENDS
REINVESTED

INTERNATIONAL EQUITIES FUND
CAPITAL INTERNATIONAL INDEX-EUROPE,
AUSTRALIA AND FAR EAST
S&P 500

1974

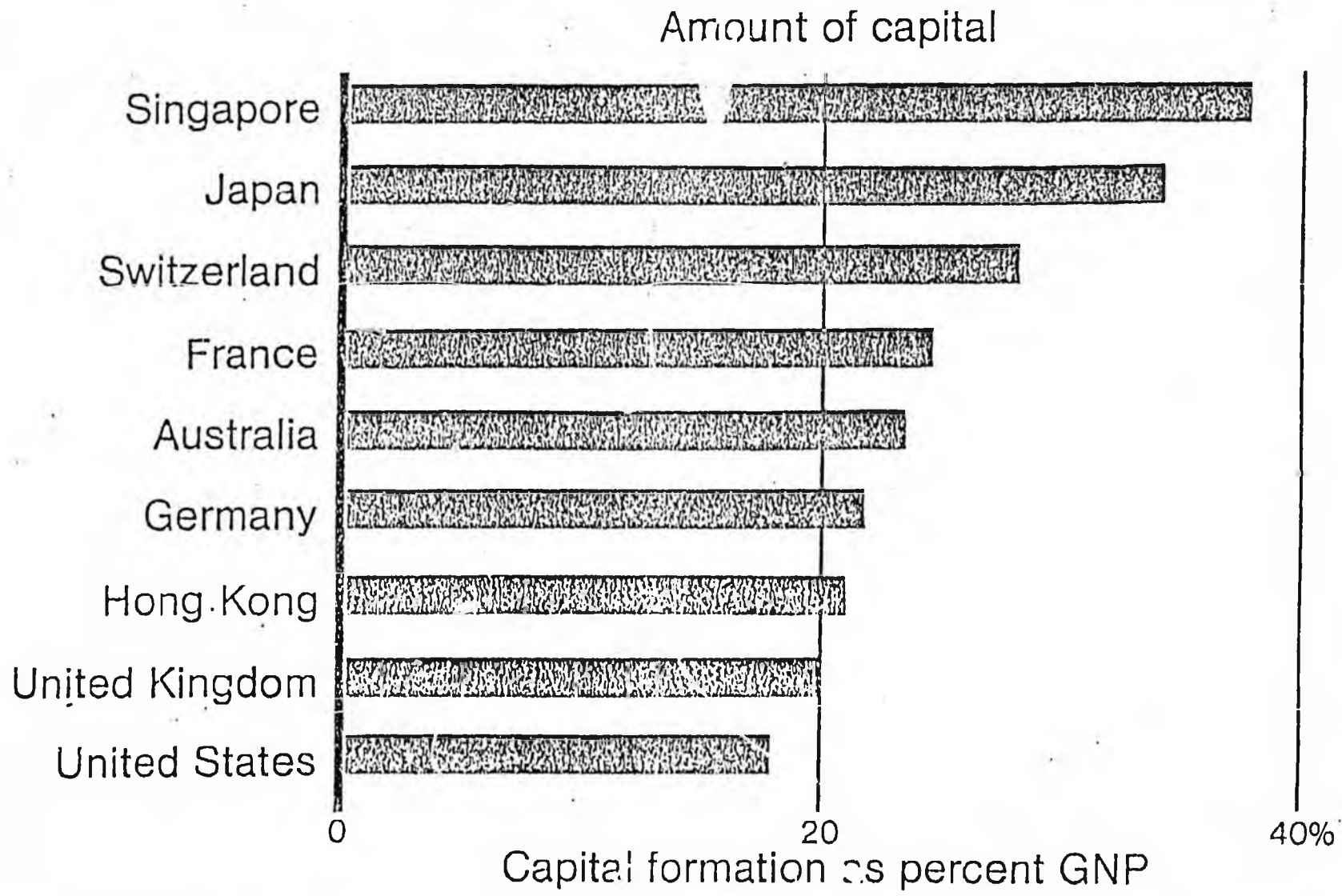
1975

1976

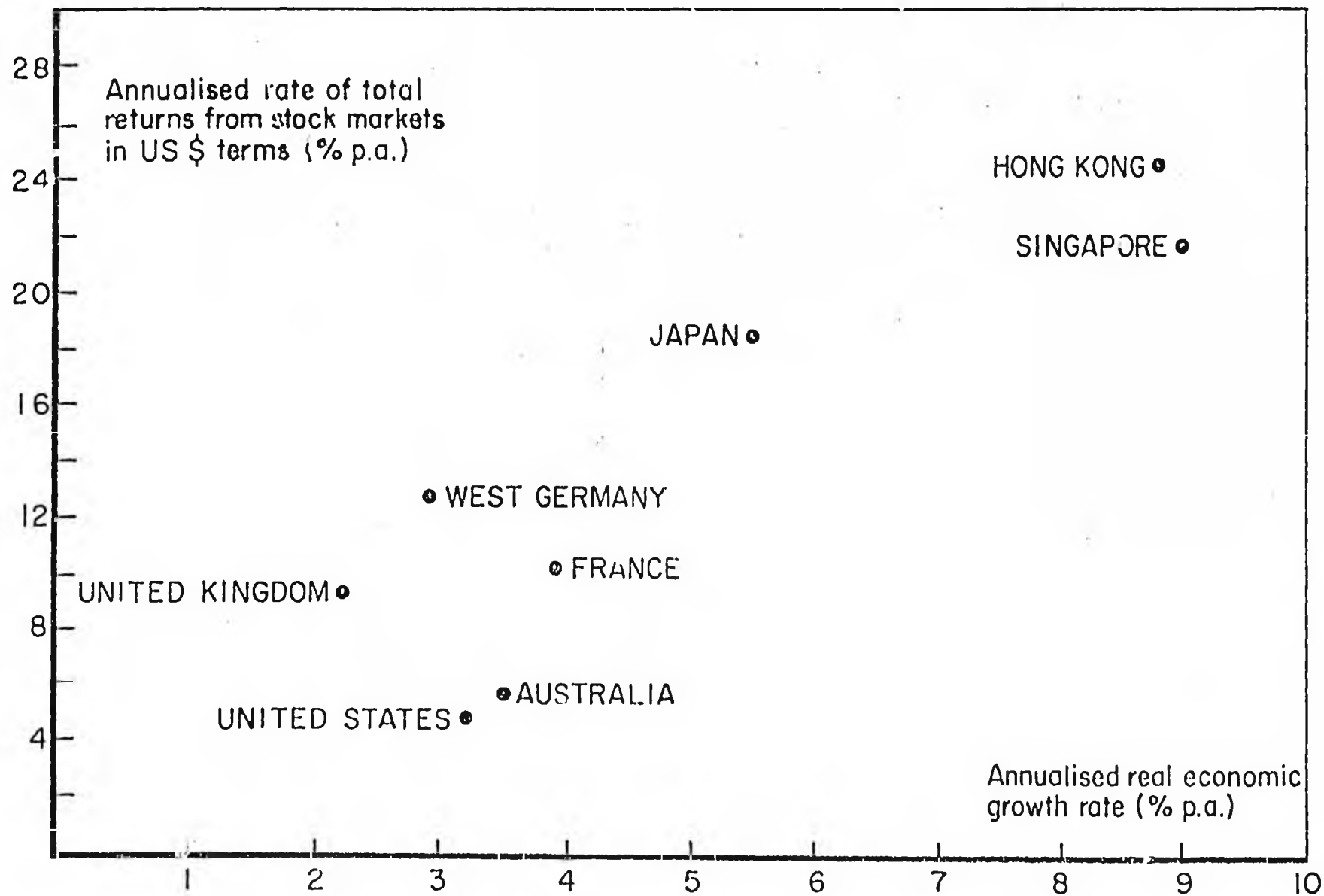
1977

1978

Greater capital formation in foreign countries leads to greater economic growth.



I. RELATION BETWEEN REAL ECONOMIC GROWTH AND STOCK MARKET RETURNS 1970-1979

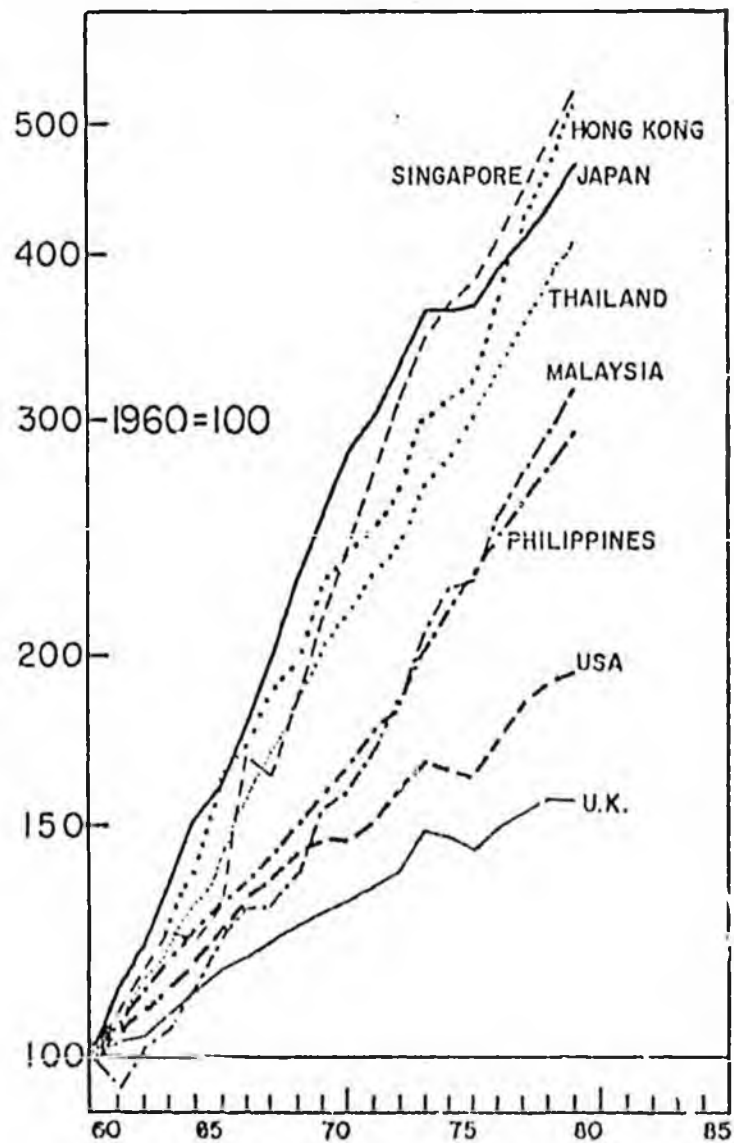


V. PROSPECTS FOR PROSPERITY IN THE 1980's

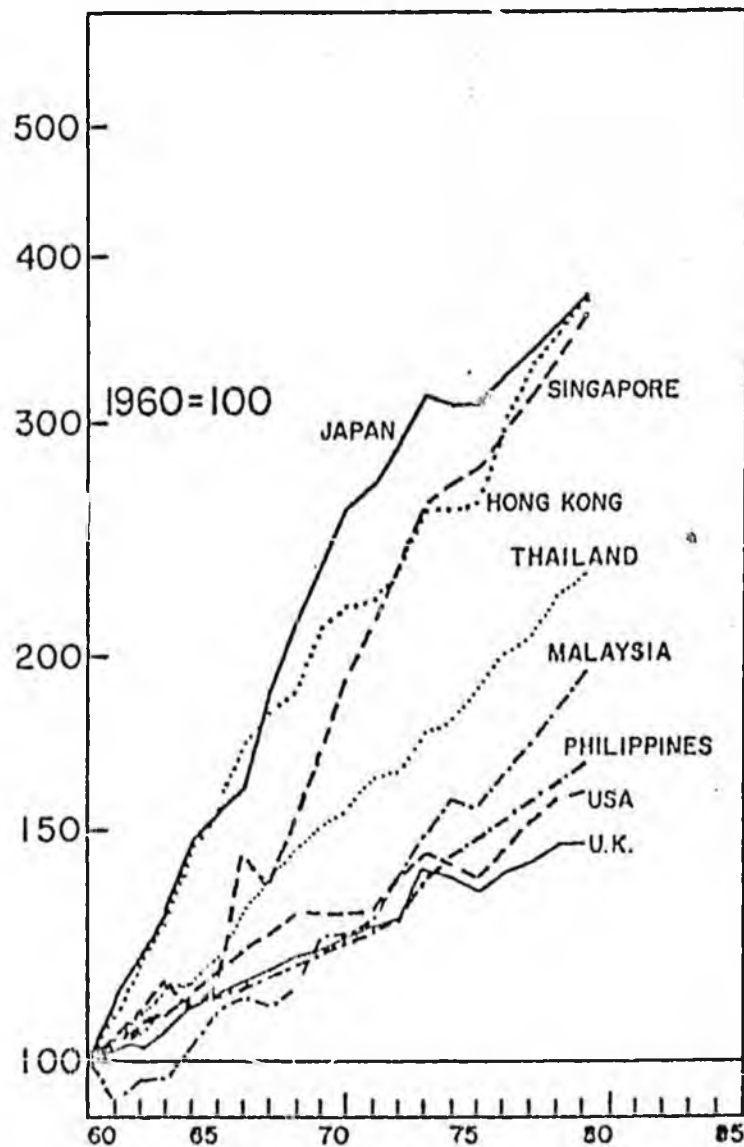
<u>GOVERNMENT CONSUMPTION AS % OF GNP IN 1978</u>	<u>SAVINGS RATE IN 1977</u>	<u>PRIVATE FIXED CAPITAL FORMATION AS % OF GNP IN 1978</u>
UNITED STATES 20.5	JAPAN 21.5	SINGAPORE 22.9
UNITED KINGDOM 20.2	FRANCE 16.1	WEST GERMANY 22.9
WEST GERMANY 20.0	WEST GERMANY 14.0	JAPAN 20.4
AUSTRALIA 16.9	UNITED KINGDOM 13.9	HONG KONG 18.2
FRANCE 15.3	UNITED STATES 5.1	UNITED STATES 15.5
SINGAPORE 11.1		AUSTRALIA 14.1
JAPAN 9.5		UNITED KINGDOM 9.7
HONG KONG 6.0	Not Available: Australia, Hong Kong, Singapore	Not Available: France

IV ECONOMIC PROGRESS IN THE FAR EAST

GROSS DOMESTIC PRODUCT GROWTH
IN ASIA



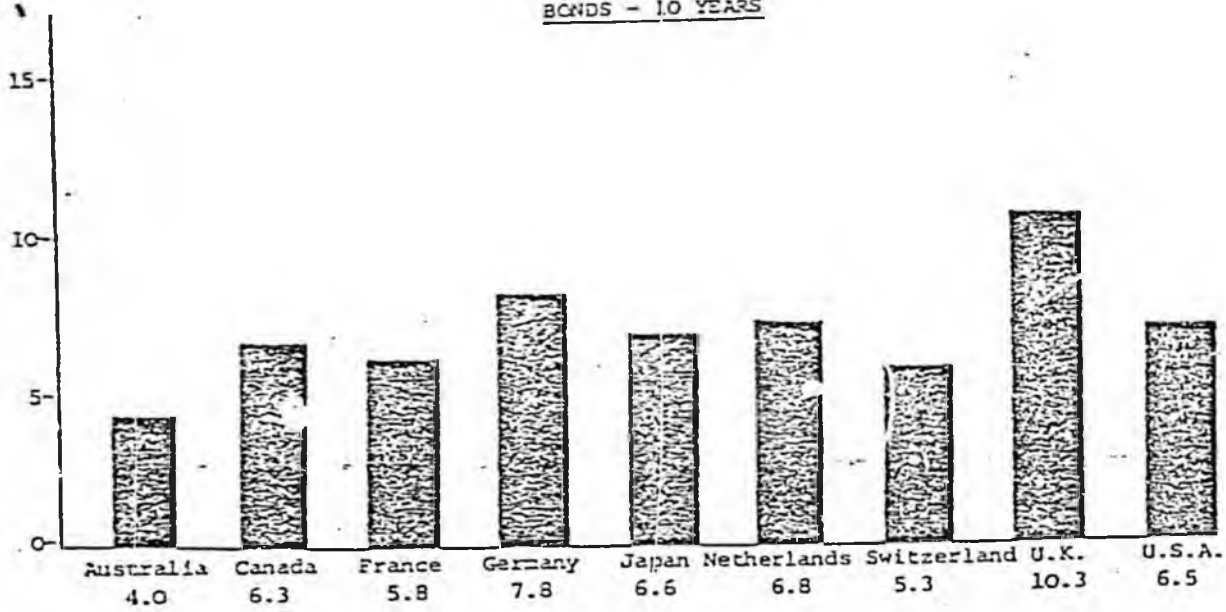
REAL PER CAPITA GDP IN ASIA



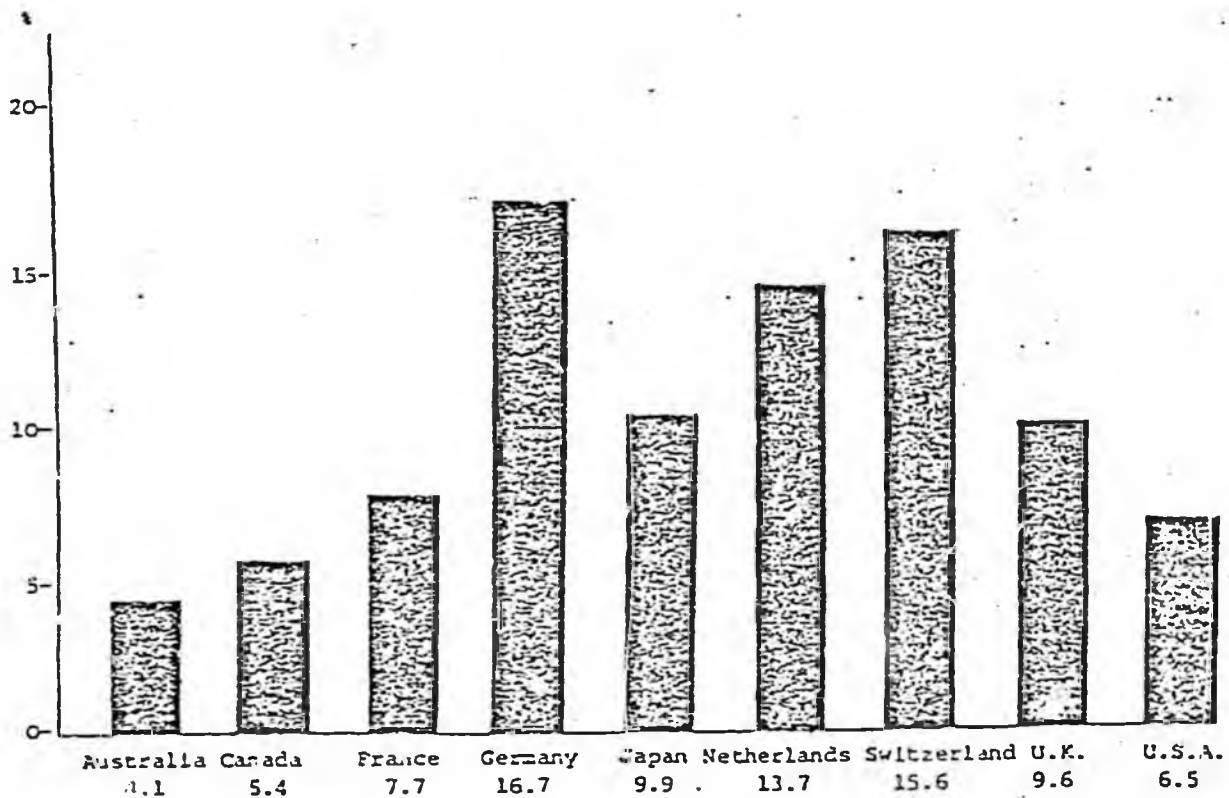
Average Annual Rates of Total Return
Bond Markets - No Currency Adjustment

1970-1979

BONDS - 10 YEARS



Average Annual Rates of Total Return
Bond Markets - Adjusted for Currency Movements relative to Dollar

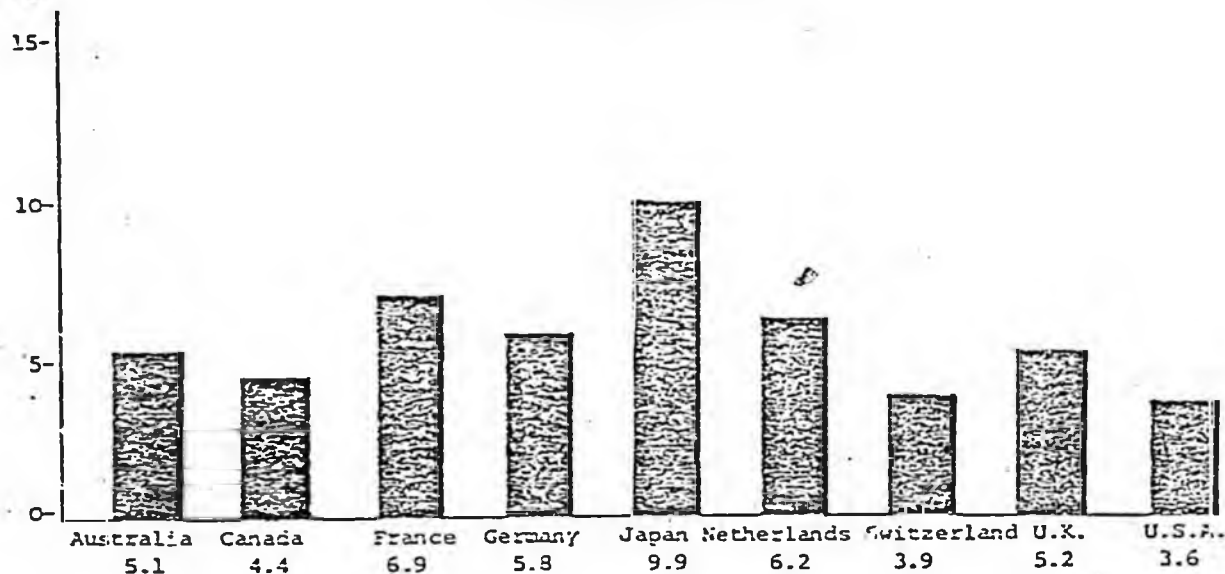


Source: Kleinwort, Benson Ltd., London

Average Annual Rates of Total Return
Bond Markets - No Currency Adjustment

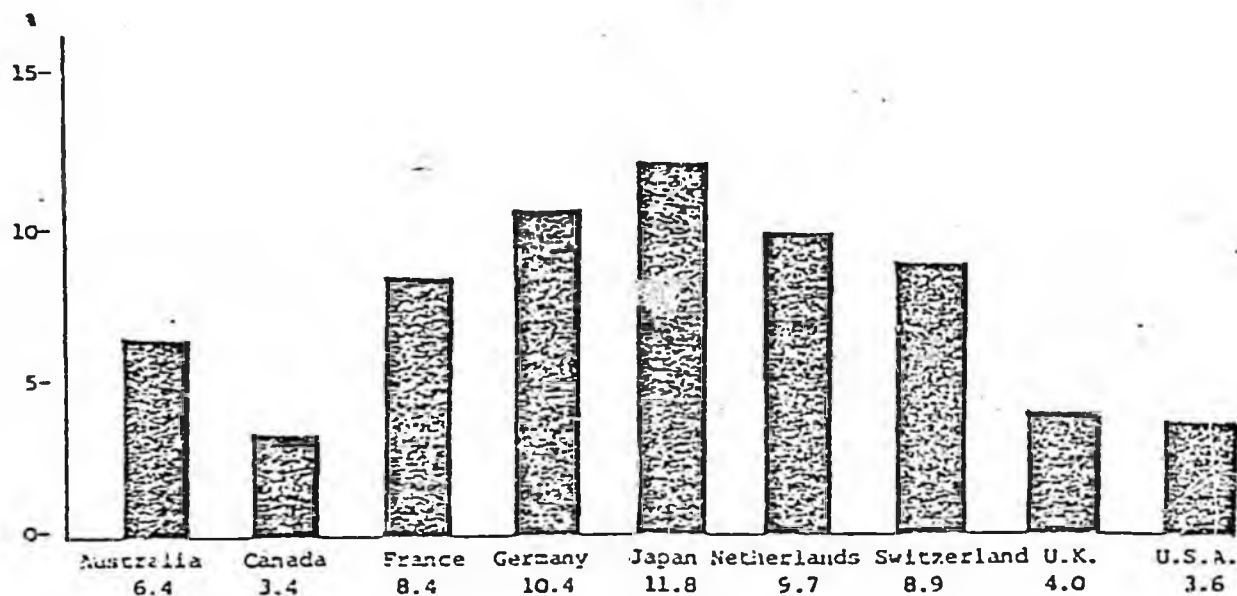
1960-1979

BONDS - 20 YEARS



Average Annual Rates of Total Return
Bond Markets - Adjusted for Currency Movements Relative to Dollar

1960-1979



Source: Kleinwort, Benson Ltd., London

THE CASE FOR EURODOLLAR DEPOSITS AND C. D.s

Eurodollar time deposits and Eurodollar certificates of deposit are time deposits denominated in U. S. dollars and accepted or issued by the London branches of major European, United States, Canadian, and Japanese commercial banks as well as the international subsidiaries of United Kingdom clearing banks. The Eurodollar deposit and C. D. markets grew rapidly in the 1960's in response to measures taken by the United States to restrict the outflow of dollars. Significant growth is also attributable to the tight money periods of 1966 and 1969 when short term rates in the United States rose above the maximums U. S. commercial banks could pay on domestic time deposits in accordance with Regulation Q. This forced U. S. banks to borrow heavily from their branches abroad where interest rates were not regulated.

As the result of recurrent balance of payments problems during the 1960's, such foreign investment controls as the Interest Equalization Tax, Voluntary Foreign Credit Restraint Guidelines, and Overseas Foreign Direct Investment Regulations were instituted. Although these controls effectively closed the U. S. capital markets to foreign borrowers and prevented U. S. firms from transferring capital abroad, they contributed significantly to the development of an active market for U. S. dollars on deposit outside the U. S. In early 1974, these control programs were all eliminated. Many observers thought that the Eurodollar market as a result would disappear. However, since no reserve requirements were levied on these deposits, the continued growth of the Eurodollar market was assured. The lack of reserve requirements enabled banks to pay higher interest on deposits while at the same time charging a lower rate on loans and still to increase profits. The volume of outstanding Eurodollar negotiable C. D.s continued to grow to its present size of approximately \$32 billion while the much larger Eurodollar deposit market has grown to an estimated \$425 billion.

Most Eurodollar negotiable C. D.s are issued with maturities up to one year by prime international banks. Banks usually quote rates for three, six, and twelve month maturities, corresponding to their loan rollover requirements, rather than for all maturities as in the United States. U. S. purchasers of Eurodollar C. D.s include commercial bank portfolios and trust departments, corporations, insurance companies and various other institutions. In addition, a large number of foreign entities are active participants in the Eurodollar C. D. market. Investors generally receive an additional 1/8 to 1/4% in yield over domestic C. D.s of the same issuer and maturity while a holder of a non-negotiable Eurodollar time deposit normally picks up still an additional 1/8 to 1/4%. These spreads may change as the result of the recent (November 13, 1980) requirement that U. S. and foreign agency banks hold 3% reserves against their net balances due to foreign branches. It is still too early to determine what the likely impact of this reserve requirement on the Eurodollar markets will be.

Many investment bankers and commercial banks actively trade Eurodollar C. D.s providing liquidity to these investment instruments. The standard trading units are multiples of \$1,000,000. The trading volume of Eurodollar

C. D.s has grown steadily from a monthly average turnover of about \$2.1 billion in 1974 to more than \$12 billion in mid-1979 with trades of \$20 to \$25 million not uncommon. Trading activity in the market is influenced not only by normal seasonal pressures affecting the domestic C. D. market but also by periodic loan rollover pressure and foreign exchange developments which may have a significant impact on rates, thereby presenting opportunities for the investor.

With regard to credit risk, the deposits are general obligations of the issuing bank under the laws of England where they are issued and payable. Holders of these deposits are creditors of the entire bank and not just the issuing branch. If a branch failed to pay a C. D. because of insolvency, it could be enforced against the head office of the bank. A depositor or C. D. holder could be negatively affected by government action in two ways. One would be an action of the English government such as its imposition of currency controls or interest limitations and the other would be by the action of the bank's head office. This could take the form of modification or termination of the issuing bank's liability regardless of where the holder sought payment. The chances of such governmental action are viewed as highly unlikely.

**Yields of Three and Six Month-Eurodollar Certificates of Deposit
and their Yield Spreads above U.S. Prime Certificates of Deposit**

<u>First of Month</u>	<u>Yields-</u>		<u>Yield Spreads-</u>	
	<u>Eurodollar C.D.</u>		<u>Euro \$ vs. U.S. C.D.s</u>	
	<u>Three</u>	<u>Six</u>	<u>Three</u>	<u>Six</u>
	<u>Month</u>	<u>Month</u>	<u>Month</u>	<u>Month</u>
1974-Jan.	10.00%	10.00%	+ 80	+150
Apr.	9.81	9.81	+ 6	+ 51
July	13.31	13.31	+121	+151
Oct.	11.69	11.75	+ 89	+105
1975-Jan.	9.63	9.44	+ 53	+ 74
Apr.	6.55	6.94	+ 46	+ 54
July	6.50	7.00	+ 20	+ 30
Oct.	7.63	8.25	+ 53	+ 20
1976-Jan.	5.63	6.25	+ 13	+ 30
Apr.	5.31	5.88	+ 11	+ 28
July	5.88	6.50	+ 14	+ 30
Oct.	5.56	5.75	+ 21	+ 25
1977-Jan.	4.88	5.00	+ 23	+ 20
Apr.	5.06	5.31	+ 16	+ 16
July	5.63	5.81	+ 25	+ 21
Oct.	6.69	6.94	+ 29	+ 24
1978-Jan.	7.00	7.25	+ 20	+ 25
Apr.	7.20	7.50	+ 35	+ 20
July	8.35	8.70	+ 25	+ 15
Oct.	9.30	9.60	+ 40	+ 35
1979-Jan.	11.45	12.00	+ 55	+ 50
Apr.	10.35	10.82	+ 35	+ 32
July	10.40	10.38	+ 60	+ 51

Volume Outstanding of U.S. and Eurodollar Certificates of Deposit
and Secondary Market Turnover of Eurodollar Certificates of Deposit
(Billions of U.S. Dollars)

Mid-month (Approx.)	U.S. C.D.s	Eurodollar C.D.s	
	Total Outstanding (1)	Total Outstanding (2)	Secondary Market Turnover (3)
1974-Jan.	65.6	11.1	2.3
Apr.	71.8	13.7	2.0
July	83.0	13.0	1.4
Oct.	88.7	12.5	2.5
1975-Jan.	91.4	11.6	3.3
Apr.	85.2	11.2	2.2
July	80.9	11.8	2.1
Oct.	83.3	12.4	3.7
1976-Jan.	79.1	13.3	5.1
Apr.	69.9	14.1	4.6
July	69.5	14.9	5.0
Oct.	64.6	15.7	5.4
1977-Jan.	82.8	15.9	6.2
Apr.	59.9	17.0	5.7
July	62.5	19.0	6.3
Oct.	68.5	21.7	6.1
1978-Jan.	75.8	21.9	7.4
April	80.7	21.9*	7.5
July	87.3	22.0	4.7
Oct.	90.0	23.5	0.8
1979-Jan.	96.5	27.5	11.8
Apr.	86.5	28.1	9.3
July	79.3	32.2	12.4

REAL ESTATE INVESTMENT MARKET & REAL ESTATE EQUITY POOLS

Until the early 1960's the real estate investment market in the United States was primarily controlled by the real estate developer and the small investor or investor group. There were few large real estate projects and those that were built were either financed or owned by one of a few insurance companies purchasing for their own investment account. Industrial property was usually owned by the corporate user or leased from local investors. The market place was highly fragmented and very much an activity at the local level. Developers had small organizations and essentially seat-of-the pants entrepreneurs.

The 1960's saw an explosive demand for manufacturing, warehousing, retail, commercial and office facilities. The larger industrial and office park concepts were created and the increasing demand for capital led most corporations to a leasing posture. This was appropriate for warehousing and office facilities as a way to conserve capital for business and as a strategy which allowed reaction to changing markets. Family formation growth led to rapid residential suburban growth and as residential developments grew so did retail and commercial developments. The shopping center grew from infancy to maturity as regional enclosed mall centers creating a mini-downtown which had a major impact on residential and commercial growth patterns. During this period a very few pension funds began to acquire industrial and commercial properties for investment. At the same time, more insurance companies began to add properties to their investment portfolios. The institutional real estate investment market began to take on the characteristics of a regional and in some cases a national market.

As we moved into the 1970's real estate projects increased rapidly in size and complexity demanding a broader range of professional skills. The size of real estate development organizations expanded to handle regional as well as national areas as well as a national market.

The 1974-1976 recession dampened much corporate involvement in real estate but the demand and growth for investment grade real estate product remained intense. Demand for pension fund real estate investments during the latter part of the 1970's drove down the current cash return on investments. Appreciation in value and rapidly rising rental rates created even more demand as real estate appeared attractive as an alternative pension investment vehicle.

As we move into the 1980's, commercial and industrial grade real estate will become more and more an institutional market. The long term mortgage market is likely to see a radical change necessitating substantial equity to be raised for larger real estate projects. This will squeeze the smaller developers or will force them to sell or joint venture their projects with institutions and pension funds. The very large development projects will become exclusively an institutional and pension fund market.

Consequently, the demand for real estate facilities from the user side is currently very strong and promises to remain so during the 1980's and beyond. The demand for quality investment grade real estate by institutions and pension funds will be even stronger. This will predictably result in lower current returns and stretched out

periods to realize long term return on investment objectives. The demand from both the user and investor side combined with the effects of inflation and government regulations will continue to push real estate up at a substantial rate. Commercial and industrial real estate investments should continue to provide superior long-term returns on investments.

In the last 10 years many trust, pools or funds have been established to participate in the advantages of real estate investments. They consisted of larger mortgage companies, banks, brokerage houses and insurance companies to name a few. Insurance companies led the way since in many cases they had been involved in real estate lending or purchasing for their portfolio for the past 100 years or longer.

Real estate is not a passive investment. It is a highly complicated field requiring creative ability, qualitative as well as quantitative analysis, and most of all experience. Owned real estate has its own risk parameters quite different from those of other investments. Once purchased, it has to be managed properly. Real Estate is susceptible to vacancies, demographic change, imbalance of income to expenses, and overbuilding to name a few. Major insurance companies have the expertise as well as offices all over the country, and this is a major advantage not available to most other managers. Real Estate pools offer protection against downside risk due to vacancies or rapidly escalating operating costs. Prudently selected and maintained Real Estate can be considered a viable supplement to other portions of a portfolio.

Funds accepted for real estate pools are limited to the properties available for purchase in any given period. You advise them of your intention to join and give them an indication of the amount you would like to deposit. They will accept your funds on a quarterly basis only, and then only if they have sufficient properties in line for purchase the following quarter. They will not guarantee acceptance of your funds in a specified time frame. They will not purchase unqualified properties just because funds are available.

Just as it is sometimes difficult to get in a real estate pool, it also takes time to withdraw. It must be realized that real estate investments are relatively illiquid and should be considered long term investments. They will not force sell a property just because you want to withdraw your funds. Most pools require 90 days written notice prior to any quarterly date. This allows them time to find other investors who want to invest in the pool, thus allowing you to withdraw. However, if cash available in the pool is sufficient to allow your withdrawal earlier, they will honor your request.

We're sure everyone will agree that any investment portfolio, pension fund or permanent fund in this case, should have the ability to diversify its investments. We have all witnessed the ups and downs in stock and bond markets over the years. Good real estate on the other hand on average has always increased in value. Investment decision makers have finally been convinced that real estate deserves a place in a well diversified portfolio. We believe that the current trend toward real estate as a major investment asset is both justified and of growing importance.

Many investment managers have been aware of the advantages of real estate investing but were discouraged from participating in real estate due to the lack of liquidity and risk characteristics associated with outright ownership. Real estate pool investments are designed to overcome these problems. Pool investment offers well managed diversification characteristics tailored to meet the risk to expected return and liquidity requirements of participants. The pools offer the investment advantages of a portfolio of high quality real estate, diversified by property type, lease term, tenant type and geographic location, combining a potential for capital appreciation with an attractive level of current income.

That last sentence says it all and deserves expanding upon:

Advantages

Real Estate equity pools are designed to deliver all of the advantages investors seek from real estate, without the complexities of outright ownership.

Return Potential

Over the years, carefully selected real estate has demonstrated a consistent ability to produce attractive yields.

Inflation Hedge

A rapid increase in real estate values has become increasingly evident in recent years as escalating construction costs have exerted upward pressure on the replacement cost of commercial and industrial properties. An attractive hedge against inflation.

Portfolio Diversification

Real estate assets produce very positive diversification characteristics when introduced into the typical portfolio of stocks, bonds, mortgages and money market investments to name a few.

A real estate pool also provides diversification of property types such as shopping centers, apartment and office buildings, motels, hotels, industrial and warehouse buildings, etc. Geographic diversification is provided through purchases of property from coast to coast including Alaska.

As more and more investors become aware of the advantages of diversification and returns available on these pools, the demand has been increasing. With this demand there has been an increasing number of pools going on line, which makes good real estate investments harder to find.

The better real estate pools do not speculate as Real Estate Investment Trusts (REIT's) did back in the late sixties and early seventies. Real Estate Investment Trusts began in 1960 when Congress passed the Real Estate Investment Trust Act.

The purpose was to provide more capital to satisfy the growing demand for long term investment money by opening the field to individual investors. The mortgage type REIT created the surge of popularity between 1969-71. Underwriters encouraged banks and others to establish trusts because the shares were easily sold and good fees were to be made. The REIT's borrowed heavily from banks and others to support their demand for more money to lend construction and development projects. Serious problems began to surface in 1974 when the prime rate soared past 12% and some construction loans reached 18% to 20%. Many could not pay and projects could not be completed and many failures resulted. Insurance company pools do not sell shares to the public, do not get involved in development projects until completed, and best of all do not borrow money to purchase real estate investments.

The insurance companies described on the following pages, in our opinion, are among the best in the industry. Other pools are available, some managed by non insurance companies, and other insurance companies also have pools. We presently have retirement systems funds in the pools with companies used as examples.

PRUDENTIAL INSURANCE COMPANY OF AMERICA

Prudential is the largest private real estate investor in the United States. As of June 1980 their estate investment department employed a professional staff of almost 500 persons located in Prudential Corporate Headquarters and 71 field offices in the United States and Canada. They manage nearly \$18 billion of real estate investments, including \$14 billion in mortgages, \$3 billion in wholly owned properties and over \$1 billion in joint ventures throughout the United States.

Because of their nationwide structure, the real estate department has established direct working relationships with regional and national real estate developers, brokers, managers, and investors. These relationships allow Prudential to consider property opportunities on a national basis.

Prudential Property Investment Separate Account (PRISA)
 (\$2 billion) Annual Historical Performance

<u>Year</u> <u>Ending</u>	<u>Gross</u> <u>Return</u>	<u>Net</u> <u>Return</u>	<u>Breakdown of</u> <u>Net Return</u>	
			<u>Income</u>	<u>Appreciation</u>
12-31-79	25.4%	23.9%	8.8%	15.1%
12-31-78	20.9	19.5	9.0	10.5
12-31-77	12.0	10.7	7.8	2.9
12-31-76	9.3	8.5	7.5	1.0
12-31-75	9.5	8.3	7.0	1.3

Geographical Location

<u>As of 6/30/80-%</u>	<u>Regions (30 States)</u>
22%	West
20%	South
18%	Mid-West
40%	East

Property Diversification

39%	Office Buildings
23%	Industrial Buildings
16%	Hotels & Motels
19%	Shopping Centers
3%	Apartments

AETNA LIFE INSURANCE COMPANY

Aetna's Real Estate Department has been in operation for over 100 years, and in the last 10 years has established an equity unit responsible for buying and managing equity real estate. Aetna's real estate and mortgage portfolio exceeds \$5 billion. The real estate department is comprised of 130 employees with a variety of backgrounds in real estate. The department utilizes both correspondents and direct lending capabilities. They are affiliated with over 85 mortgage bankers in major metropolitan areas who are under contract to produce real estate and mortgage investments. Their internal National Accounts unit deals directly with major real estate development companies which operate on a national basis.

Aetna Real Estate Separate Account
(\$300 MM) Annual Historical Performance

	<u>Yield</u>	<u>Appreciation</u>	<u>Total Return</u>
Jan.-Dec., 1978	7.73%	.82%	8.55%
Jan.-Dec., 1979	9.03%	3.54%	12.57%

Geographic Distribution

<u>As of 6/30/80-%</u>	<u>Regions</u>
30%	Rockies
16%	South
18%	Mid West
3%	East
33%	West

Property Diversification

45%	Retail Buildings
2%	Land
20%	Office Buildings
19%	Industrial
14%	Warehouse Buildings

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY

The John Hancock's Real Estate Department has been in existence for over 100 years and currently manages a portfolio of commercial and agricultural real estate and mortgages of all types in excess of \$4 billion. In addition to a staff of in-house professionals including 50 mortgage investment officers, they have advisory and origination capability from a network of 58 mortgage banking firms and their branch offices located in major metropolitan cities from coast to coast. They also have eight agricultural loan agencies in the major farm areas of the country, and maintain extensive contact with major property developers as well as the mortgage and real estate brokerage community.

(\$350 MM) Equity Real Estate Account (ERA)
Annual Historical Performance

	<u>Yield</u>	<u>Appreciation</u>	<u>Total*</u> <u>Return</u>
Jan. - Dec., 1977	9.1%	1.2%	10.3%
Jan. - Dec., 1978	9.3	2.5	11.8
Jan. - Dec., 1979	10.2	8.8	19.0

Geographic Distribution

<u>As of 6/30/80-%</u>	<u>7 Regions (21 States)</u>
11%	New England
13%	Middle Atlantic
15%	Southeast
30%	Midwest
5%	Southcentral
13%	Mountain/Southwest
13%	Pacific

Property Diversification

32%	Industrial Buildings
8%	Hotel
28%	Warehouse Buildings
13%	Office Buildings
17%	Shopping Centers
3%	Retail Stores

EQUITABLE LIFE ASSURANCE COMPANY

Equitable's Real Estate Department has been in operation for over 115 years and has been involved in equity real estate ownership and management for over 25 years with over \$3 billion under management. The real estate department presently has a staff of over 500 full-time real estate professionals. The department utilizes both correspondents and direct lending capabilities with their own nationwide network of 40 offices. They are also the investment advisor to Equitable Life Mortgage and Realty Investors, a Boston based real estate investment trust listed on the New York Stock Exchange.

Equitable's Equity Real Estate Account
(\$1 billion) Annual Historical Performance

<u>Year</u> <u>Ending</u>	<u>Yield</u>	<u>Appreciation</u>	<u>Total</u> <u>Return</u>
12-31-75	9.8%	(2.2%)	7.6%
12-31-76	8.7%	1.5%	10.2%
12-31-77	9.1%	2.2%	11.3%
12-31-78	9.2%	4.7%	13.9%
12-31-79	9.3%	5.5%	14.8%

Geographic Distribution

<u>As of 6/30/80-%</u>	<u>Regions</u>
32%	Southern
29%	Central
15%	Western
14%	Mid-Atlantic
10%	Northeastern

Property Diversification

64%	Retail
16%	Office
15%	Industrial
2%	Hotels
2%	Land

PERFORMANCE FIGURES - POOLED REAL ESTATE ACCOUNTS

INVESTMENT RETURN NET OF INVESTMENT FEES

<u>YEAR</u>	<u>INSURANCE COMPANY</u>			
<u>Ending 12/31:</u>	<u>Prudential PRISA</u>	<u>Aetna</u>	<u>John Hancock</u>	<u>Equitable</u>
1979	23.9%	12.6%	17.8%	13.9%
1978	19.5	8.6	10.8	14.4
1977	10.7	--	9.3	10.0
1976	8.5	--	--	8.9
1975	8.3	--	--	6.3
Assets at Market 12/79 (000)	\$1,493.70	\$184.75	\$180.02	\$903.09

THE CASE FOR COMMON STOCK

One investment paradox is that common stock can be used to reduce portfolio risk. For example, adding small amounts of common stock to bond portfolios will usually reduce the standard deviation of total portfolio returns. This is due to the "magic" of diversification. In many years, such as 1979-80, stock prices go up while bond prices go down and stocks thereby provide a cushion against bad bond markets. To make this point even more specific, Salomon Brothers reports that an average which they maintain of a variety of both short and long term debt, securities provided total returns of 1.2% in 1979 and .1% in the first nine months of 1980. By contrast, the Standard & Poor's Composite Index produced total returns of 18.2% and 20.6% for the respective periods. Listed below are the total returns for common stock management achieved by Alliance Capital Management Corporation for the Alaska Teachers' Retirement System for the past six calendar years.

Performance Review

Yearly Summary	Rate of Return
1980 through Sept. 30	27.5%
1979	18.5%
1978	7.8%
1977	-3.4%
1976	23.4%
1975	28.8%
1974	-17.5%

Cumulative Return Since Inception - 106.5%

Even though there has been seemingly endless streams of negative news including ever-higher oil prices, the Iran crisis, continued double digit inflation, and rising interest rates, there are good reasons for viewing the common stock market as affording a good, long term investment opportunity.

The common stock of many companies is selling well below book value at a time when replacement costs are rising more rapidly than general price levels. At a time when diamonds, paintings, and condominiums in California have reached record levels, the assets of many American corporations are still selling at a fraction of their replacement value. From an earnings standpoint, the progress of American corporations, notwithstanding two recessions, has been dramatic. From 1969 to 1979, the Standard & Poor's 500 was flat. Corporate profits during the same period tripled.

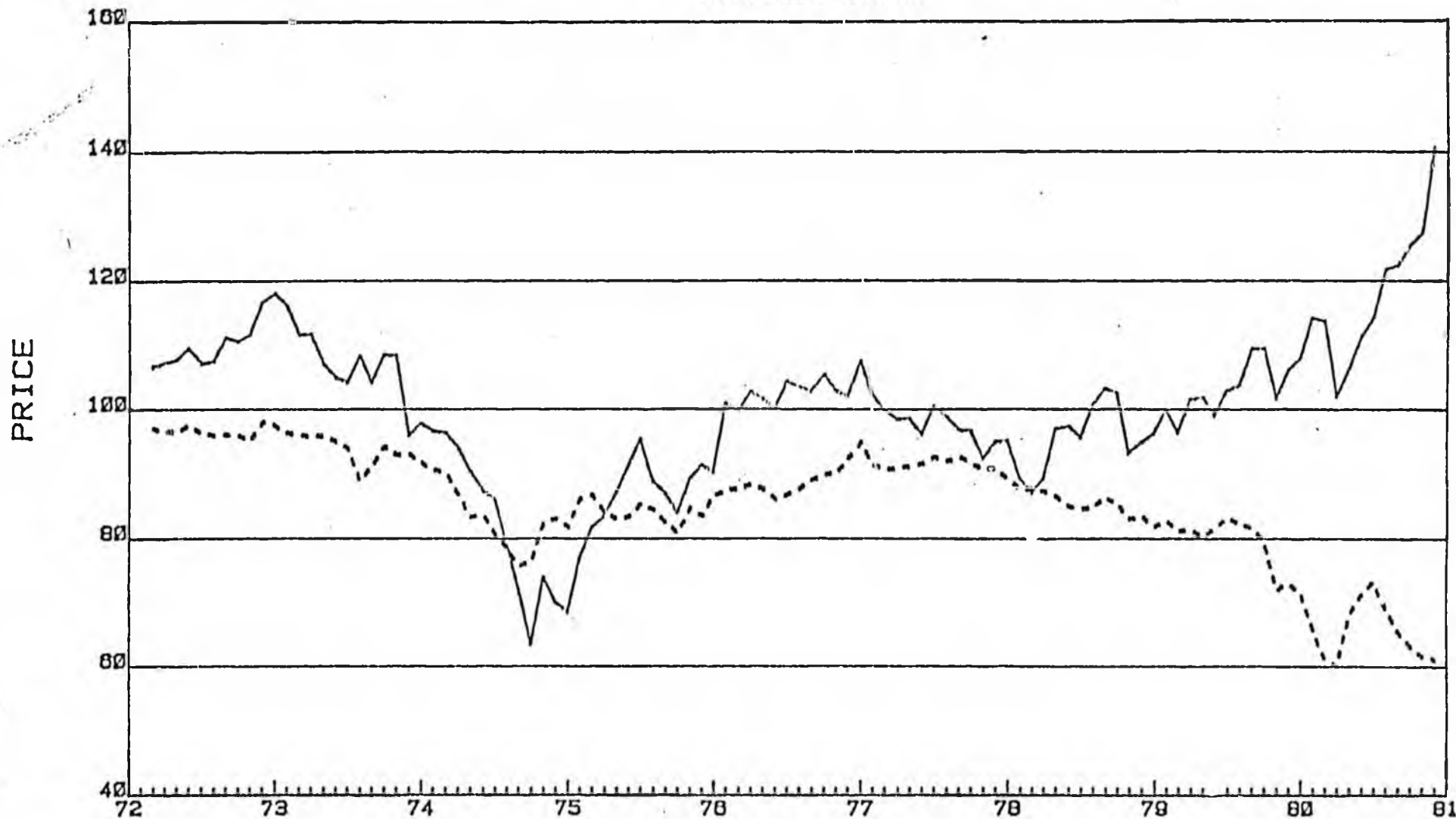
Since 1969, private pension funds have substantially reduced their holdings in common stocks. Insurance companies have reduced their equity positions to extreme low points. For example, fire and casualty companies hold only 12% of their assets in equities. Foreigners likewise hold a

record low percentage of their funds in U. S. common stocks. While foreign investors commitments to the U. S. market have fallen, their assets in gold and other currencies have multiplied many times, making their potential purchases extremely large. Japanese pension funds have been recently authorized, for the first time, to hold up to 20% of their assets in foreign securities. Individuals are another potential source of demand, having been net sellers of stock for years. On the other hand, there are estimates that \$30 billion in common stock have been taken off the market in recent years through direct corporate purchases. Given the right set of circumstances, perhaps moderating inflation, or improved tax treatment of dividends and capital gains, and a generally more favorable attitude towards capital formation this obvious potential demand could well be converted into real purchasing power producing substantially higher valuations for common stocks in general.

It is also true that over the long-term the best rates of return have been provided by the common stock market. From 1926-1979 common stocks as represented by the Standard & Poor's Composite Index have provided a 6.1% real rate of return while long-term corporate bonds have provided a real rate of return of only 1%. The cumulative impact of these differentials is graphically displayed in "Wealth Indices of Investments in the U. S. Capital Markets 1926-1978".

PRICE PROFILE

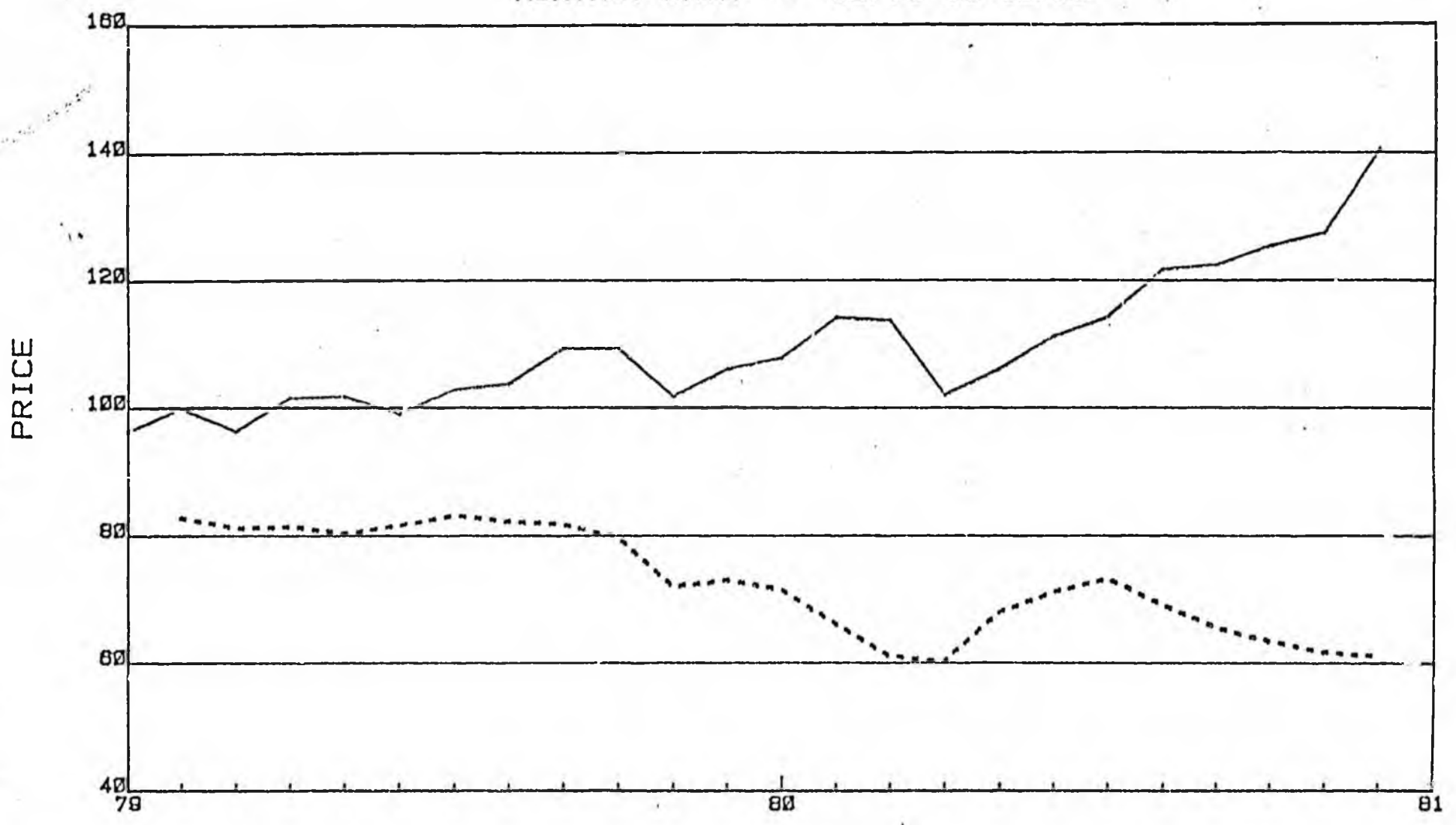
PREPARED FOR THE STATE OF ALASKA
MONTHLY DATA



— S&P 500
- - - SALOMON BOND INDEX

PRICE PROFILE

MONTHLY DATA - 12/78 TO 12/80



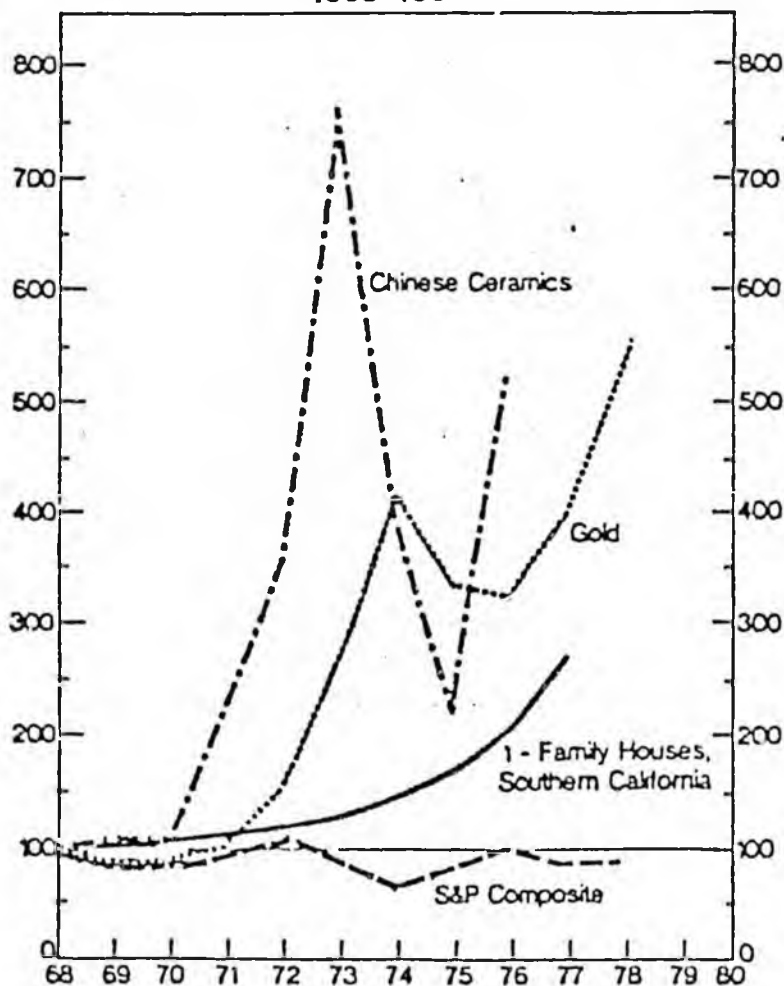
— S&P 500
- - - SALOMON BOND INDEX.

ALLIANCE CAPITAL MANAGEMENT CORPORATION

INFLATION IMPACT

	<u>1975-1979</u>	<u>9 MOS. 1980</u>
CONSUMER PRICE INDEX	47.9%	9.6%
STANDARD & POORS 500	99.9	21.0
ALLIANCE EQUITY FUND COMPOSITE	141.1	28.0

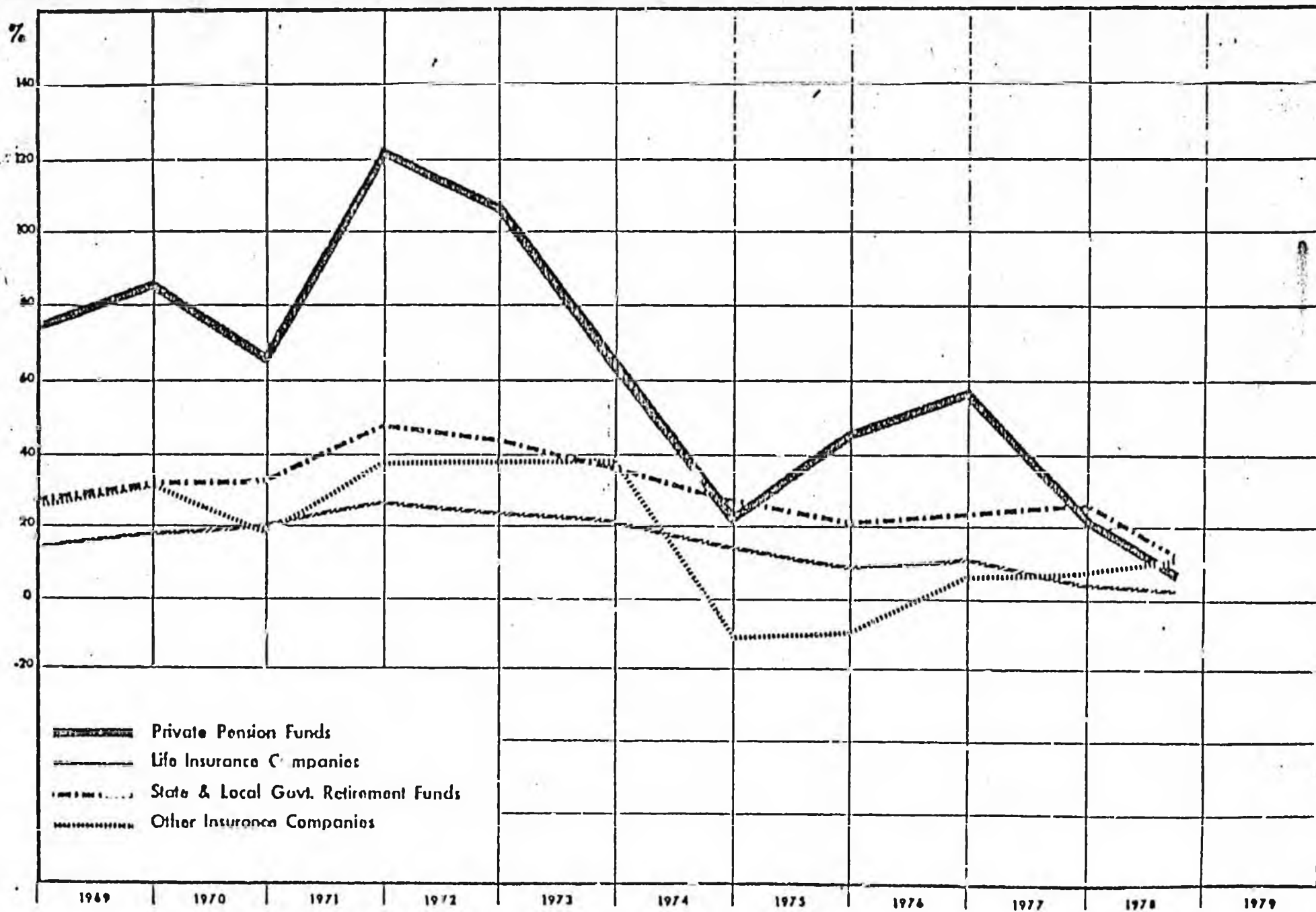
MOVEMENT OF TANGIBLE ASSET INDICES
1968=100



Source: Lehman Brothers Kuhn Loeb Research, Commodity Research Bureau, Real Estate Research Council of Southern California, Sotheby's and Parke-Bernet.

	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978
Gold	100	84	90	104	155	268	417	336	322	395	541
Year to Year % Change		-16	7	16	49	73	55	-19	-4	23	45
Chinese Ceramics	100	110	111	229	359	762	391	223	530	N/A	N/A
Year to Year % Change		10	1	106	57	112	-49	-43	137	N/A	N/A
1-Family Homes So. Cal.	100	105	109	114	119	128	146	168	205	267	N/A
Year to Year % Change		5	4	4	5	8	14	15	22	30	N/A
S&P Composite	100	84	85	93	110	89	63	83	98	86	90
Year to Year % Change		-14	-1	10	18	-19	-29	32	18	-10	2

Net Purchases of Equities as a Percentage of Cash Flow



STOCKS, BONDS, RISK FREE ASSETS & INFLATION

COMPOUND GROWTH RATES: 1926 - 1979

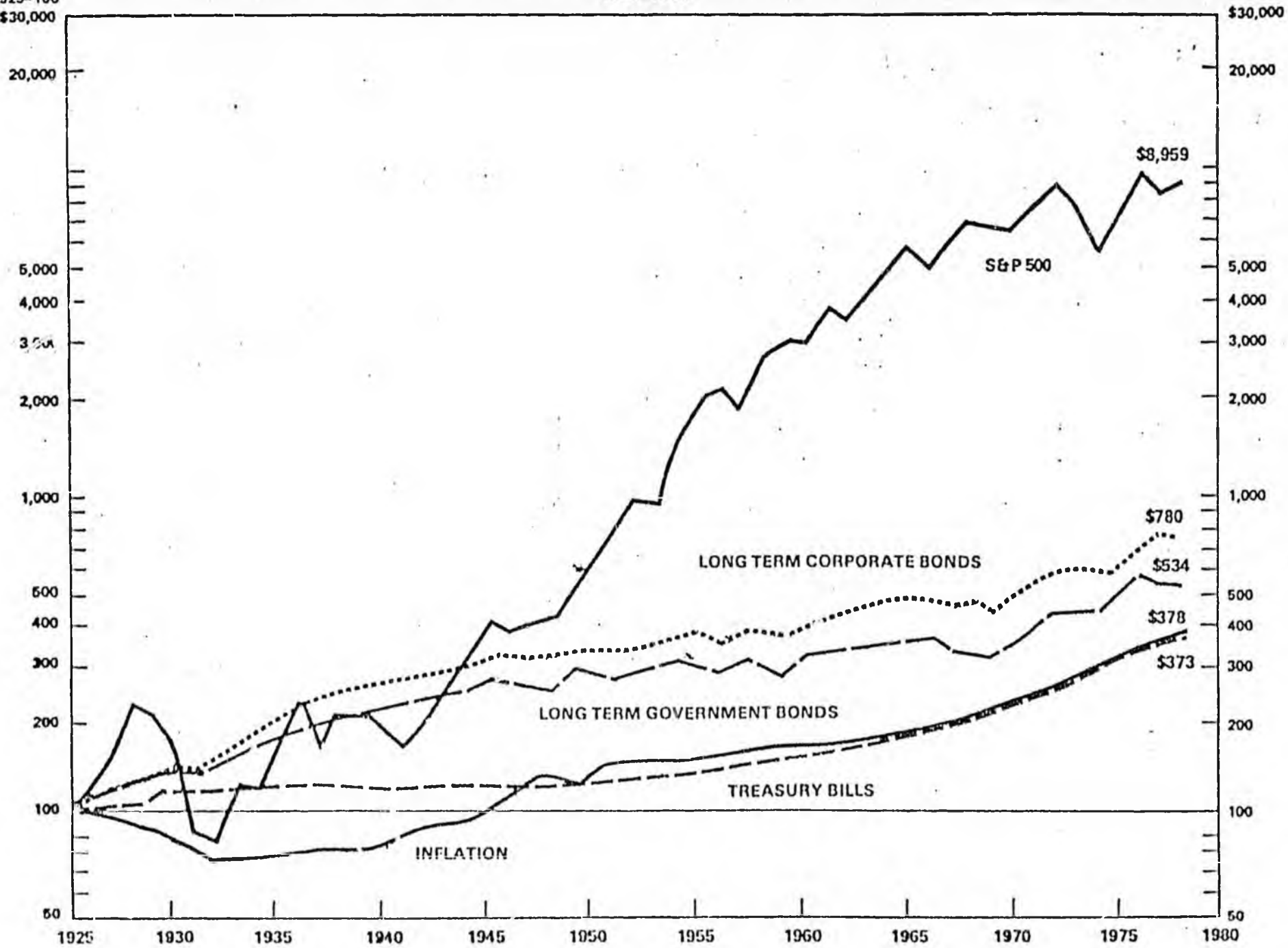
	NOMINAL	REAL
COMMON STOCKS (S & P 500)	9.0%	6.1%
LONG-TERM CORPORATE BONDS	3.8%	1.0%
TREASURY BILLS	2.7%	(0.1%)
INFLATION	2.7%	-----

Source: Ibbotson-Sinquefeld

WEALTH INDICES OF INVESTMENTS IN THE U.S. CAPITAL MARKETS

1926-1978

Index:
1925=100
\$30,000



Prepared by Alliance Capital Management Corporation based upon data presented in Stocks, Bonds, Bills and Inflation: The Past (1926-1976) and The Future (1977-2000) published in 1977 by the Financial Analysts Research Foundation.

ALASKA PERMANENT FUND CORPORATION

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RESPONDENT ADDRESS

TO: Senator Mulcahy, Chairman
Senate Labor and Commerce Committee

FROM: James B. Rhode, Special Assistant to the Trustees
Alaska Permanent Fund

DATE: March 12, 1981

SUBJECT: Sectional Analysis of Sponsor Substitute for SB 684

PREFACE

Nearly one year ago, the Trustees of the Alaska Permanent Fund and the Special Liaison Committee of the Legislature, chaired by Senator Sturgulewski, began a series of seminars and work sessions on the future of the Fund.

From the first, it was agreed to explore the issues in the context of how all the oil revenues were, or might be, spent. This was to insure that any new role for the Fund would be consistent with its fundamental purposes and, too, would be more suitably lodged in the Fund than elsewhere.

Meeting at various points in the state, the group examined the ideas of economists, financial specialists, major Alaskan interests, and the general public. This is further described in the Annual Report of the Fund (pp. 3, 5-7). The analysis offered by various professionals is soon to be published under the heading of The Trustee Papers. A special edition, including formal statements from various groups and citizens, has been compiled for the committees of referral for this bill.

SUMMARY

SB 684 contains three key proposals: (1) having the public members comprise the majority of the Trustees to slow the effects of a change of administration or a change in political moods; (2) revising the list of permitted investments to be the same as for the pension funds (with some added restrictions and excepting gold, which does not produce direct income), as holding the best hope for long-term rates of return that exceed inflation without sacrifice of safety; and (3) reinvesting one-half the Fund's earnings to protect the buying power of the Fund's principal and income from inflation, and providing that the remaining earnings be paid over on the basis of a five-year average with, in effect, a reserve to keep those payments as stable as possible for state planning.

ANALYSIS

Section 1. The replacement of a commissioner by a public member in the composition of the Trustees has the dual effect of giving the public members the working majority and requiring that majority to have special qualifications for their office. In the discussion of this provision, it was felt that the Commissioner of Revenue, as the State's chief fiscal officer, must be formally accorded the role that he will always exercise in Administration decisions on the Fund. As well, this insures the Administration will be directly informed of the views of the Trustees. The provision to eliminate one commissioner was to recognize the growing demands placed upon the cabinet in recent years. While noting the advantage of having three commissioners during the organizational phase of the Fund, it was felt that it would be difficult to expect that many to be able to devote the necessary time indefinitely.

Sections 2 and 3 have the practical effect of staggering terms so that a governor will only be able to select all of the Trustees by the last year of his term. This gives a greater measure of independence to the board over existing law (where the next governor would have chosen a majority within six months of taking office), but also mitigates the deletion of existing language (p. 2, lines 2-3) which, on the basis of a decision of the Alaska Supreme Court, does not permit confirmation by the Legislature without constitutional amendment.

In like manner, section 4, requiring that a governor remove only for good cause, is designed to replace the check in the existing statute where the Legislature, by vote, can halt a removal.

Section 5. A majority of the Trustees felt that an annual fee for members of the board was justified on several grounds: The management of a fund of this size will involve working subcommittees and considerable travel to meet with outside fund managers, with financial advisors, and with senior officials in similar institutions. Assuming the likely stature of the public members, it was thought just to compensate them for the significant loss of income entailed by their work, and wise to prevent appointees from stating that personal circumstances limited the amount of time which they could devote. The annual fee, here tied with the salaries of legislators, is to be on the order of \$20,000 a year, which is the sum typically paid by leading corporations to outside directors. This figure was consciously set to be insufficient to draw potential appointees for the sake of the fee alone.

Section 6 adds to the list of permitted investments for the Fund with the dual aims of improving long-term, real earnings and giving needed diversity. At present, the Fund is essentially a large "money market" account of the kind now open to many private individuals. However, a number of financial specialists have pointed out that, on average over the decades, these securities have only matched inflation or have been somewhat negative in terms of real earnings. The situation of the past two years, with as much as 6% return above inflation, happened but once before in this century: 1931. Interest rates were then at a bare 1% but price levels had fallen 5%, thus giving a real income of 6%. Based on this historical data, our existing investment list promises few years in which earnings can exceed inflation. In contrast, the investment areas proposed to be added (stocks, income property, and foreign assets) have brought yields in line with the long-term real growth of the United States, 2 to 4% beyond inflation and, in some years, particularly in Japan and the strongest economies of Europe, the gains have been more substantial. To be sure, not all of these investment areas have performed well in every period owing to economic cycles, political and other events, and changes of investor preference. Indeed, our advisors have stressed that no guarantees against fluctuations can be offered for any class of investments, not even the highest grade of U. S. Government securities. (Actually, in recent years, the latter have swung more sharply and more often than other instruments). Hence, the necessity of having, now, a wider selection of proven investment options so that adjustments can be timely and of enough size to win better returns while avoiding reverses - both in a manner consistent with safety of principal.

It would be well to note here that section 7 places limits on the extent to which investments, other than fixed income securities, can be made and the limits are more severe than for the pension funds. The lack of a limit on fixed income securities is not because they afford markedly greater safety; in certain markets, they do not. Rather, the projected growth of the Fund, even with declining revenues, is such that it could, absent restraints, cause these markets to rise and fall by the very fact that it was buying and selling. Further, the limits are proposed by the Trustees as part of their commitment to gain experience in these new areas on a gradual, deliberate basis.

Ironically, our present investment list is not truly "conservative," in the sense of protecting either the current dollars or real worth of the Fund's corpus and income. Our list, by the standards of comparable institutions and court rulings, is more accurately described as "traditional". Most participants in the drafting of this bill were stunned to learn that a \$10

billion fund, earning 15% a year, suffering 10% inflation, and paying over all of its returns, would shrink in 30 years to less than \$250 million in value. The goods and services that could be purchased with the income of this fund would collapse in the same ratio, from \$1.5 billion at today's prices to \$89 million in three decades. Or, more graphic still, a dividend of \$1,500 would then buy what \$89 will buy today. Accordingly, whether one believes that the Fund's principal should be conveyed intact to the next generation or the Fund's income should be conveyed equally to present and future Alaskans, a portfolio that loses to inflation will serve us at the expense of those who follow. (Please see Appendix A for a more detailed analysis of the financial sections.)

Section 10, 11. Broadly, these sections provide that one-half the net earnings of the Permanent Fund shall be retained in principal and the balance is available for distribution on a five-year average, with any excess to be used to raise payments in a year they would fall below the average. The first is to sustain the real earnings power of the Fund; the second is to give the Legislature a stable income on which to plan.

More specifically, the Fund's earnings can be expected to rise steadily over the next decade as the result of regular contributions and competent management. During this period, more income will be made than is necessary to meet the five-year average, and the excess and the interest on it will build up in the "undistributed income account." In the first year if that income were to fall below the average, the reserve would be drawn upon. In the event that it was judged that reserves were ample, a larger dividend could be declared or, perhaps, the extra sums could be applied to other purposes by the Legislature.

Section 12 simply provides that the Fund's expenses will be met from the Fund's earnings (as "program receipts"), however, no money may be spent except as provided by the budget. Although the control of the Legislature is not altered in any way, this approach plainly shows what it has cost to make our income, thus allowing the public and legislators to better assess the worth of these expenses. This practice is virtually universal in the accounting of similar private institutions.

Section 13 is to allow the Legislative Budget and Audit Committee to be selective as to which financial and operational reports it prepares, or has prepared, in the light of circumstances. For example, this language would permit the Fund and the Committee to reach mutual agreement on a firm to assess performance in different areas of investment and, further, to reach mutual agreement on definitions of terms,

the proper sample of statistics, and the like. This "ground rules" approach will aid fuller disclosure of the Fund's activities while at the same time reduce temptations for either side to craft reports that are merely designed to attack or defend the Fund.

Section 14 brings the Permanent Fund into conformity with the law governing most other boards and commissions.

BUDGETARY NOTES

The Trustees ask that SB 684 be considered together with the Governor's budget request to achieve independent status for the Permanent Fund, and with the fiscal note which provides for outside, specialized firms to carry out the new investment authority under this bill.

Independence for the Permanent Fund has been the clear preference of public and legislative sentiment to date. (Please see the paper on the relevant legislative history prepared by Trustee Peter B. McDowell.) The case for independence, in brief, is that special interests pressing the Fund to win concessions will be more visible in their attempts and that your Trustees can be held to fuller account if they choose their own servants. The last point is not meant to reflect on the present Commissioner of Revenue or the staff of the Treasury. On the contrary, their ready cooperation has been frequently noted in the record of the Trustees. But it has been the consistent advice of professional managers that "... those committed to investing must have their operations separate from those committed to spending ...", especially given the "... great, tempting size ..." of the Fund. In the wealthiest state in the nation, California, where state and local pension assets exceed \$30 billion, such a separation has always been maintained.

Still, after independence has been attained, the Fund will have less freedom than any independent board or commission in present law. For the Fund has the most definite charter in state government, is not permitted to spend, does not lend directly to any borrower, and is subject to all the oversight that is applied to a line agency.

As for the fiscal note, the Trustees have agreed that outside managers are best suited to execute the new investment authority in this bill. In addition to our remoteness from the markets involved, there are numbers of reputed firms that can do this work more efficiently, and for less cost, than it can be done internally.

APPENDIX A

ANALYSIS OF FINANCIAL SECTIONS

SSSB 684

Peter A. Bushre

Deputy Commissioner of Treasury

Department of Revenue

Current law provides the corporation with the authority to place funds in direct obligations of the United States Treasury, federal agency securities, certificates of deposit, high-grade corporate bonds, quality short-term investments, and federally guaranteed loans. Management is directed to give preference to Alaska investments as long as they meet the standards of quality set out in the bill. Specifically, deposits can be made in Alaska banks, mutual savings banks, savings and loan associations, and credit unions. Residential real estate (owner-occupied single family dwelling, duplexes, and condominiums) may also be purchased if the mortgage is privately insured by a company doing business in Alaska.

The permanent fund statute has a minimum of investment restrictions yet provides a very definite and certain framework. It does not authorize investments in stock or bullion, restricts the purchase of corporate bonds to 25% of the Fund's total investments, and limits the purchase of loans and mortgages to 25% of the total. Purchases of residential mortgages may be a further 15% of total assets. The statute allows the Fund to use the futures market to protect investments

from severe declines in value that are being suffered today. These futures contracts, however, may be used only to hedge and not to speculate. The statute also prohibits the Fund from either borrowing or guaranteeing the obligations of others.

Section 6 of the bill would amend the present investment list by adding five categories currently authorized for the State pension funds and by conforming other language to the retirement system law. The additional investments are:

1. Commercial mortgages - loans secured by a first lien on commercial properties such as shopping centers, office buildings, etc. The corporation may purchase uninsured loans if the originating financial institution retains at least 25%, or insured loans which meet requirements currently in effect for the pension funds.

2. The common stock of U. S. corporations which have paid dividends in each of the immediately preceding three years.

3. Stocks and bonds that are denominated in foreign currencies or Eurodollars, provided that they are of the same quality as their U. S. counterparts.

4. Bank deposits that are denominated in foreign currencies or Eurodollars, provided that they are readily negotiable or that the issuing bank has capital and surplus of at least \$500 million.

5. Equity interests in commingled pools of real estate.

Section 7 of the bill reduces the limit on loans and mortgages to 15% and restricts the investment in foreign securities and bank deposits to the levels which currently prevail in the retirement systems. Common stock and corporate debt are together limited to 50%; both are more restrictive than the pension funds. The bill further limits the permanent fund to no more than 5% of the voting stock of any one corporation, and domestic stocks, with the exception of insurance companies and banks, must be listed on an exchange registered with SEC. Both are identical to current limitations on pension fund investments.

Section 8 would standardize the collateral requirements for deposits with all types of financial institutions, and require them to pledge U. S. government securities, corporate bonds, or mortgages if their certificates of deposit are not freely negotiable.

NOTE REGARDING THE FOLLOWING FRAME ON MICROFILM:

COMPLETE DOCUMENT IS AVAILABLE IN ORIGINAL FILES
IN ALASKA STATE ARCHIVES. TITLE PAGE ONLY HAS
BEEN FILMED.

Remarks to the Alaska Permanent Fund
Board of Trustees

October 22, 23, 1981

GROUPS

Commonwealth North
Resource Development Council For Alaska
Fairbanks Homebuilders Association Inc.
Alaska Municipal League
Alaska State Chamber of Commerce (includes follow-up letters)
Interior Mortgage and Housing Association, Inc.
Alaska Association of Realtors
Alaska Home Builders Association, Inc.
Alaska Public Interest Research Group
Alaska Mortgage Assurance
FREE Committee

INDIVIDUALS

Gregg Erickson (transcript excerpts)
Arlon Tussing (transcript excerpts)
Scott Goldsmith
John Havelock (transcript excerpts)

COMMENTS TO THE
TRUSTEES OF THE PERMANENT
FUND

by

DR. HARRY DONAHUE
Representing Commonwealth
North
October 22, 1981

COMMENTS TO THE PERMANENT FUND TRUSTEES
OCTOBER 22, 1981, 9 am
Captain Cook Hotel

THANK YOU MR. CHAIRMAN, TRUSTEES OF THE PERMANENT FUND,
AND LEGISLATORS.

WE APPRECIATE THE OPPORTUNITY TO OUTLINE SOME OF THE
CONCLUSIONS REACHED BY THOSE OF US IN COMMONWEALTH NORTH WHO
HAVE BEEN STUDYING THE WISE USE BY THE STATE OF ALASKA OF
ITS REVENUE STREAM AT THIS FORTUNATE TIME IN OUR HISTORY.

IN NOVEMBER 1979, A COMMITTEE WAS FORMED OF 15
OUTSTANDING ALASKANS TO WORK ON MANY OF THE ISSUES THAT YOU
ARE ADDRESSING. THE GROUP WAS CHAIRED BY BILL SHEFFIELD AND
INCLUDED TWO FORMER COMMISSIONERS OF REVENUE, RON RETTIG AND
ERIC WOHLFORTH.

THE GROUP MET WITH AND TESTIFIED BEFORE THOSE
LEGISLATORS WHO WERE DESIGNING THE PERMANENT FUND STATUTE.
WE OPPOSED WHAT WAS THEN KNOWN AS SB 1 AND URGED THAT THE
STATE NOT FALL INTO THE TRAP OF BECOMING AN ENORMOUS LENDING
INSTITUTION.

AND YET WE FELT THERE WAS A ROLE FOR OUR GOVERNMENT TO
PLAY IN INVESTING WITHIN THE STATE IN THOSE PROJECTS THAT
COULD STRENGTHEN THE LONG-TERM ECONOMIC HEALTH OF ALASKA.

IN APRIL OF 1980 THE LEGISLATURE PASSED A BILL WHICH AVOIDED THE PITFALLS OF SB 1 AND WAS PRUDENT IN ITS CONSERVATIVE APPROACH, ^{in favor of} FAVORING A SAVINGS/INCOME PHILOSOPHY.

OUR REACTION TO ^{the} THIS LEGISLATION WAS POSITIVE. BUT TWO ISSUES HAD BEEN LEFT ON THE TABLE:

1. ^{first,} HOW ^{would} THE INVESTMENTS ALLOWED BY THE FUND ~~WOULD~~ KEEP PACE WITH INFLATION, AND
2. ^{second,} ^{how would the state make} INSTATE INVESTMENTS IN THE CAPITAL INFRASTRUCTURE.

OUR COMMITTEE MEMBERS FELT THAT THE INCOME FROM PERMANENT FUND INVESTMENTS SHOULD NEITHER BE DISTRIBUTED TO THE POPULACE NOR WHEN THE STATE HAS SUFFICIENT REVENUE FOR ITS NEEDS, ^{should be} SIMPLY BE ADDED TO THE GENERAL FUND, BUT ^{rather it} REINVESTED IN THE PERMANENT FUND ITSELF, SO THAT THOSE DOLLARS TRULY BECOME A RENEWABLE RESOURCE.

IF THE TRUSTEES DECIDE THAT MAKING LOANS IS A PROPER ROLE FOR THE PERMANENT FUND, WE WOULD OPPOSE DIRECT LENDING... ^{We are, instead,} URGING A COMMITMENT TO SECONDARY LENDING ONLY. USING PERMANENT FUND MONEY IN THIS MANNER WOULD RECEIVE OUR SUPPORT IF THE YIELD TO THE FUND IS AT AN ACCEPTABLE LEVEL.

FURTHERMORE, OUR COMMITTEE SUGGESTED THAT INVESTMENTS BY THE PERMANENT FUND BE BROADENED TO INCLUDE APPRECIABLE ASSETS, ^{in order} TO HELP STAY AHEAD OF INFLATION.

it makes little sense

TO CONVERT AN EQUITY ASSET ^{that is} (RAW OIL IN THE GROUND THAT CAN ^{or} AND-WILL APPRECIATE OVER TIME) INTO A FIXED INCOME ASSET WITH LITTLE OR NO APPRECIATION POTENTIAL ~~MAKES LITTLE SENSE.~~

SOME OF THESE FUNDS SHOULD BE INVESTED IN ASSETS THAT CAN PRODUCE INCREASING INCOME. ONE EXAMPLE OF THIS STRATEGY MIGHT BE MAJOR PROPERTY INVESTMENTS, AS THE UNIVERSITY OF WASHINGTON HAS ^{invested in this manner} ~~DONE SO~~ SUCCESSFULLY FOR DECADES. RENTS ARE ADJUSTED OVER THE YEARS TO OFFSET THE INROADS OF INFLATION.

RAILROAD CARS AND OIL TANKERS COULD BE OTHER EXAMPLES. DIVIDENDS ON COMMON STOCKS HAVE HISTORICALLY INCREASED EVEN DURING PERIODS OF WEAKNESS IN THE MARKET. THERE ARE MANY SUCH EXAMPLES, MOST OF WHICH HAVE THE ADDED ATTRACTION OF BEING ABLE TO INCREASE IN VALUE AS WELL.

→ TO ENCOURAGE INVESTMENT WITHIN THE STATE IN CAPITAL PROJECTS, WE FIRST THOUGHT THAT THE PERMANENT FUND SHOULD TAKE THE LEAD. *in order*

WE TALKED TO A NUMBER OF LEGISLATORS AND INDIVIDUALS THROUGHOUT THE STATE AND CAME TO THE CONCLUSION THAT THIS ^{at least} WOULD BE DIFFICULT TO ACHIEVE POLITICALLY. THE PUBLIC VOTED FOR THE PERMANENT FUND CONSTITUTIONAL AMENDMENT IN 1976 SO THAT IT WOULD, INDEED, BE A PERMANENT FUND. THAT SENTIMENT CONTINUES.



Resource Development Council

for Alaska, Inc.

444 West 7th Avenue, Anchorage, Alaska 99501
Box 516, Anchorage, Alaska 99510 - 907/278-9615

EXECUTIVE DIRECTOR
Paula P. Easley

October 22, 1981

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Board of Trustees

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James Wakefield
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Dun Wald

The Resource Development Council has been asked to study the potential investment activity of Alaska's Permanent Fund. As you are aware, the existing law requires 25% of royalties and bonuses on oil and gas leases to be placed in a permanent fund. This rate will increase to 50% on all future sales by statute. Due to the investment restrictions placed upon the fund, investments are primarily made outside the state of Alaska. Our state has few investments which will meet the fund's existing criteria. Currently one-third of it is invested in intermediate term instruments while the balance is short term.

It is our belief that the funds should be invested within the state. Investment outside allows the fund a relatively low-risk return on investment but does little for the average Alaskan. The first priority of the fund is that it should be used for residential mortgages, and secondly for commercial real estate mortgages. This will provide the Fund with an average rate of return on its investment and would allow Alaska to participate directly from our oil wealth.

Underwriting criteria for mortgage loans are standardized and this will allow for proper credit underwriting, thus insuring loan portfolio quality. We advocate a 10% mortgage rate net to the borrower. This rate will allow for an investment return but will more importantly create a stable secondary market for loans which will assist permanent home construction statewide. Any rate of return calculation must reflect all of the costs incurred by the investment activity. The true yield of our present investing is less than currently indicated as the state is absorbing a portion of the costs.

The fund would be used to purchase loans from existing financial institutions located in the state. An underwriting and servicing agreement with the respective institutions would allow for proper underwriting and file maintenance.

STAFF CONSULTANTS
Terry Brady
Dr. James Drew
Sara Hemphill
Dr. Arthur H. Hoyer
Robert Hux
Frank H. Jones
Dr. William Ogle
Cate Tubbs

This would allow private sector involvement utilizing existing personnel thus eliminating the need for another layer of underwriting. Direct purchase of loans would not only alleviate duplicative underwriting but would eliminate the need for costly bond sales to fund the purchases.

Alaska has the capital, and to enter the public market place at current high rates subsidizes the investors or bondholders to the detriment of all residents. The fund would be used for single family, then commercial mortgages with refinances and assumptions allowed at low cost.

The permanent fund belongs to all ^{the} residents of the state. Any program for ^{the} distribution may be classified as inequitable and perhaps inflationary by some groups. However, we have discussed many types of investments and have determined the mortgage program as discussed herein as the most beneficial. We feel that ^{the} mortgage demand should be satisfied by the fund first and any surplus ^{the} remaining should be invested in money market instruments or other prudent investments.

^{and Shacks}
Respectfully submitted, ^{by}

John D. Shackelford ^{our} Chairman

For the RDC Permanent Fund Committee

(Members: Tom Fink
Bill Purrington
Perry Eaton
Roger Haxby
John Shackelford



Fairbanks Homebuilders Association Inc.

P. O. BOX 80215 - FAIRBANKS, ALASKA 99708

October 20, 1981

Clai Porter
118 East International Airport Road
Anchorage, Alaska 99502

Dear Clai;

After discussing the Permanent Fund with the Board of Directors of the Fairbanks Association, the following was decided to be our official position:

The impact of the housing industry on the state economy is great and far-reaching. Not only does the stability of the industry affect the small nucleus of contractors and their employees, but has a much farther reaching affect. It affects the lives and livelihoods of the suppliers and subcontractors who provide materials and labor into each house, the banker who processes the construction and long term loans, the appraiser who calculates the value, the insurance agent who insures the property, the title company who insures the title, and the real estate agent who assists in the sale of the finished product. The construction of a new home, increases the tax base of the city or borough, and creates new ongoing business for the utility companies that service each new home.

To own a home is the American dream, it is big business and it affects the livelihoods of a great variety and a large network of Alaskans. We believe in this industry, one of the backbones of the American Economy.

As you are certainly aware of, Alaska Housing Finance Corporation must go to the Bond Market to procure funds for housing loans in Alaska. Not only does the State of Alaska have to subsidize the interest rate in order to bring housing loans to Alaskans at a reasonable rate, but we are forced to sell bonds at current interest rates, which AHFC has no control over.



Fairbanks Homebuilders Association Inc.

P. O. BOX 80215 · FAIRBANKS, ALASKA 99708

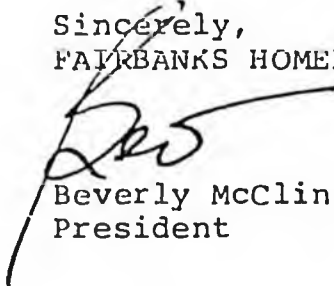
If part of the Permanent Fund could be used to finance the AHFC housing bonds, the return to the Permanent Fund could be consistent with what the return is today on existing investments with the added advantage of keeping the money in the State of Alaska, and providing jobs and prosperity for Alaskans, and better housing for ourselves and generations to come.

Stability in the housing industry is desperately needed, and with funding from the Permanent fund, this sought after stability could be brought to the industry to benefit the citizens of Alaska today and tomorrow.

Would you please see this is read or given to the Trustees at the hearing in Anchorage on October 22, and 23rd. It could be incorporated into the Building Industry Position if it is compatible.

Thank you for your help.

Sincerely,
FAIRBANKS HOMEBUILDERS ASSOCIATION



Beverly McClintock
President

Remarks of TED LEHNE, President of the Alaska Municipal League and member of the City Council, City of Fairbanks, Alaska

To the Alaska Permanent Fund Corporation, Anchorage, Alaska, October 22, 1981

Mr. President and Trustees. My name is Ted Lehne, I am President of the Alaska Municipal League, ^{The Alaska Mun. League is} a statewide association of 52 Alaska cities and boroughs ^{which} representing over 90% of the state's population. I ~~am~~ ^{happy to be} also a member of the City of Fairbanks City Council.

The League appreciates the opportunity to meet with you today. ^{at the beginning} I feel compelled to ^{make a few} ~~begin with some~~ disclaimers. I ~~do not~~ ^{don't} claim to have great wisdom about investments. I still have to stop and think which is which when people refer to bull and bear markets. But I know there's hope ^{for me.} I was raised far from an ocean and am not nautical. ^{and I have figured out} ~~But I finally learned~~ the difference between port and starboard.

^{also have it} I must be upfront and admit I'm a politician. Frankly, I do so somewhat sheepishly. I heard recently of the person who was visiting a cemetery and read a gravestone which said "Here lies a politician and an honest man." He turned to his companion and said "I wonder how they got two people in that narrow grave."

^{Well,} But despite those handicaps I think I and the League can contribute to your dialogue. ^{Today.}

In local government we believe in the wisdom of the saying that government is more responsive the closer it is to the citizen. We appear to have an ally in the White House, and another in the Executive Mansion in Juneau. But like so many these days we seem on the verge of being loved to death by those who believe in us but really don't understand us. Let me tell you something about local government in Alaska.

First, ^{it's} it is alive and well. Some think it is a bit too alive, but that attitude is ^{not} held by ^{everybody} most citizens. An Outside taxpayer group reported

earlier this week that Alaska led the nation in the amount, ^{that} its state and local government spent per capita. State government spending was five times the national average and local government spending was twice the national average. ^{I should have to point out} ~~We should keep in mind~~ that the State of Alaska plays a much bigger role in education than probably any other state and that probably accounts for an important part of the reason why state government spending is so high compared to the national average.

In fiscal year 1980 local governments in Alaska raised from local sources about \$248,000,000. ^{million} In that fiscal year State shared revenues and municipal assistance amounted to about \$30,000,000 ^{million} and federal shared revenue was about \$25,000,000. ^{million} There was about another \$10,000,000 ^{million} in various other outside aid programs.

That means that in fiscal year 1980 local governments had about \$310,000,000 ^{million} available to spend (not counting state education or capital monies) and about 80% ^{that money} of it came from local taxpayers.

I should pause here for one additional qualification. Throughout this discussion I will omit ^{referring to} state aid to education. It is substantial and growing. The state provides both operating funds and capital construction funds as well as monies this fiscal year for school debt retirement.

These funds are enormously important in keeping down local taxes.

I omit discussion of them, not because they are not important, ^{But} simply because others in the educational community can discuss that aspect of state aid much more intelligently and thoroughly than I can.

To return, I had indicated that in fiscal year 1980 local governments had about \$310,000,000 ^{million} to spend and raised about 80% of it locally. The state's share was about \$30,000,000. ^{million}

By fiscal year 1981, after taking a hefty supplemental appropriation into

account, state municipal assistance and municipal revenue sharing had increased to about \$97,000,000^{million}. Many municipalities reduced taxes or at least avoided increasing them any, despite inflation.

In the current 1982 fiscal year the amount in those two programs reached just under \$140,000,000^{million}.

Now I'm going off into the realm of speculation^{a bit} to make a point.

Lets assume that on average municipalities in Alaska balanced their local budgets in fiscal year 1980 - in other words that they in total spent the \$310,000,000^{million} they had available to spend. We have to

speculate here because there simply are no good figures^{for} about total expenditures of local government^{around the State}. If we assume 10% annual inflation,

then the total expenditures in fiscal year 1981 were about \$340,000,000^{million} with 63% raised locally. And the total expenditures in fiscal year 1982 will be about \$375,000,000^{million} with 55% raised locally.

By the way, our taxpayer study group^{what} I referred to earlier said local governments in Alaska spent about \$910 per capita last year. And that's pretty close to the \$340,000,000^{million} we^{from} extrapolated~~in~~ in this example.

Here's the point. Some people^{now} feel that because state aid has risen so dramatically in the last few years that we should not have local taxes any more. My point is that municipalities, in this macro example, are still faced with raising about 55% of their revenues locally. As with any average, there are some municipalities that have actually cut back on the size of government and who raise much less than 55% locally. There are others who raise more.

^{Now,} Fifty-five percent of local government expenditures is about \$200,000,000^{million}.

If the State of Alaska wanted to do away with the need for any local revenue collection - property taxes, sales taxes, user fees, fines, etc^{and so forth} it would have to increase operating revenue shared with local governments

from about \$140,000,000^{million} to about \$340,000,000^{million} this ~~fiscal year~~. *And, of course*

That number will move with inflation. By the way, we are assuming that the additional \$35,000,000^{million} will continue to come from federal and other similar sources, and that may not be a safe assumption down stream.

Let's move on
~~New I would like to move~~ from the ^{area} arena of operating monies to talk *a little bit* about capital construction funds, ~~a bit~~.

Until the legislature adopted HB 60 last year, and HB 50 and SB 166 this year, municipalities either paid for capital improvements out of local taxes, issued general obligation or revenue bonds, or did without. *House Bill Senate Bill*

And I think we all know that most municipalities exercised the "did without" option much more often over the years than ~~any~~ others.

Because of that there were many unmet needs - what we have referred to as the necessity to improve our infrastructure. In the last two years we have gone a long way toward meeting many of those needs. The capital construction job is far from through; ^{though} It will take several years more of higher than normal levels of construction funds to meet the needs of multiyear projects in particular. Then, to keep up with growth and to avoid developing a great gap in the future, there will need to be some ongoing construction in most municipalities.

There have been two very useful characteristics of the state's approach to capital construction funds. First, it has made a point of not providing unlimited operating monies. This means the local taxpayer is faced with an important decision. Is he willing to accept the long term operating and maintenance costs of a capital project, if there are such costs? Some municipalities have shied away from projects with a high O & M price tag - my own municipality of Fairbanks is one. The total of

^{of} all the capital projects ^{that} we have approved to date will actually decrease our O&M costs, not increase them. At least that's what our staff tells us.

The second element of the approach specifies the mechanism by which the voter is asked his opinion - the feature of SB 168 that requires approval by ballot for new projects over \$1 million and renovation projects over \$5 million. Even though the City of Fairbanks was one of the few municipalities that had a major project turned down in local elections earlier this month, I still believe that ^{that's} ~~is~~ a useful requirement for large state-funded capital projects.

The state's participation in capital funding is important to local tax payers and rate payers. The \$40 million in the current fiscal year budget to retire school construction debt will significantly reduce the interest and principal payments of many boroughs. And projects built from scratch with grant funds ^{of course,} carry no debt service.

With that background, I would like to offer ^a ~~one~~ broad suggestion and two specific ones.

I have noticed as I have served on national boards that in many parts of the country local and state governments don't get along all that well.

In fact, I have come to feel that Alaska is fortunate that we have an emerging partnership between our levels of government within the state. With the increasing federal emphasis on returning control and money to states and localities it appears that at least in the immediate future this kind of cooperation is a real asset.

One of my major goals ^{this year} as President of the ~~Alaska~~ Municipal League is to foster this developing relationship.

^{It} I would like to suggest today that this partnership be expanded to include the Alaska Permanent Fund Corporation. It ^{is} clear that your

corporation can play an increasingly important role in the lives of our citizens as time goes by, ^{particularly as the Chairman says if permanent really means permanent,} I think everyone in the state will be better off if state government, local government and the Permanent Fund Corporation develop effective and ongoing communication, cooperation and trust.

Specifically, I think the Alaska Permanent Fund Corporation can help municipalities and the citizens served by them in two ways. First is by serving as the vehicle for endowing local education and municipal operating costs. A year ago I appointed a task force of the Alaska Municipal League to work with the legislature to further this concept. ^{New} We have not made much progress in the last year, not because it is not a good idea, but because there were other greater priorities for the income the legislature had to spend. And, frankly, I think legislators were somewhat awed by the amount of ^{of money} money required for such an endowment fund. Many support the concept but did not see the revenues to set it up. One told me, "with the amounts ^{of money} going into the Permanent Fund I just don't see where the money will come from."

^{Well,} If the Permanent Fund Corporation would take the lead in setting up such endowments, I believe many in the legislature would support additional deposits to the Permanent Fund - deposits beyond statutory requirements - to help those funds grow. The League would welcome the chance to work for such a concept.

Second, municipalities have a problem in the bond market. I'm sure that statement is ^{not a} no surprise to anyone ^{body}. High interest rates force municipalities to postpone projects or accept higher debt service. For utility revenue bonds the current interest rates usually require ^{substantial} rate increases contributing to our high cost of living.

I believe we should aggressively explore a partnership here, too. I envision

the Alaska Permanent Fund Corporation investing in municipal general obligation and revenue bonds. Municipalities would repay the principal plus an interest rate that would be considered reasonable in more normal times - say six to eight percent. But I do not feel ^{that} the subsidy in the interest rate should come from the Permanent Fund. I propose that the third partner, state government, pay to the Permanent Fund the difference between what it would normally earn on such investments and the lower rates paid by municipalities. I believe this approach would require much smaller general fund appropriations than the current bond bank. It would hold harmless the Permanent Fund while permitting the investment of some of these funds in Alaska, and would keep down the cost of government and utility rates.

^{How} These are just two examples of how the partnership ^{that} we are advocating might work. It may not be possible to achieve these specifics. But I hope you will adopt the general premise. I believe a full partnership between Alaska's state government, local governments and this Alaska Permanent Fund Corporation can be a vital element for our future. I pledge the full cooperation of the Alaska Municipal League. Because the ones who will benefit are all of Alaska's citizens ^{that all} we serve.

Thank you.

ALASKA STATE CHAMBER OF COMMERCE'S COMMENTS ON THE PERMANENT FUND FOR THE OCTOBER 22, 1981 HEARING:

THE CHAMBER ENCOURAGES THE TRUSTEES TO WORK WITH THE LEGISLATURE IN DEVELOPING A PLAN ON ALL OIL INCOME, AND IN THAT PLAN ESTABLISH GOALS ON THE USE OF THE PERMANENT FUND MONIES SO THERE IS NOT OVER LAPPING SUCH AS IN LOAN PROGRAMS. THE STATE PLAN SHOULD FOLLOW THE SPENDING LIMITATION CONCEPT WHICH REQUIRES ALL EXCESS REVENUES FLOW TO THE PERMANENT FUND.

THERE MUST BE AN ANALYSIS OF THE USE OF THE FUND IN THE PLAN. THIS PLAN SHOULD LOOK AHEAD 1-5-10 YEARS IN SCHEDULING PROJECTS AND PROGRAMS.

THE CHAMBER SUPPORTS THE CONCEPT THAT THE FUND MUST KEEP UP WITH INFLATION, AND IS THEREFORE, OPPOSED TO ONE-HALF OF THE EARNINGS GOING TO THE GENERAL FUND.

THE CHAMBER ENCOURAGES THE RESTRUCTURING OF THE PERMANENT FUND TRUSTEES.

REPLACE ELIMINATE TWO COMMISSIONERS WITH PRIVATE SECTOR PERSONNEL PERSONNEL ON THE BOARD, SO THAT CANNOT APPOINT, IN EFFECT, FOUR MEMBERS THE YEAR HE IS ELECTED.

FOR THE CHAMBER SUPPORTS THE INVESTMENT POLICIES THAT DERIVE THE FUND A MAXIMUM RATE OF RETURN ON ITS INVESTMENTS, NOT JUST A MAXIMUM INTEREST

RATE, ~~AND~~ TAKING INTO CONSIDERATION THE MULTIPLYING EFFECT OF THOSE DOLLARS IN
THE ALASKAN ECONOMY.

THE CHAMBER SUPPORTS THE CONCEPT OF STRIVING FOR INSTATE INVESTMENTS THAT
DO NOT HAVE AN ADVERSE IMPACT ON THE PRIVATE SECTOR.

THE CHAMBER SUPPORTS DEPOSITS IN ALASKAN FINANCIAL INSTITUTIONS IN
A PRUDENT MANNER.

THE CHAMBER SUPPORTS THE CONCEPT OF BUYING MORTGAGES AT VARIABLE RATES AND
SUPPORTS THE "DUE-ON-SALE" CLAUSE.

THE CHAMBER ALSO SUPPORTS THE CONCEPT OF EXTRACTION OF EQUITY AS IT
MAY LEAD TO THE MOST PRODUCTIVE USE.

THE CHAMBER IS OPPOSED TO SUBSIDIZING LOAN INTEREST RATES AND
FEELS A SUBSIDY IS AN INEQUITABLE WAY OF DISTRIBUTION OIL WEALTH.

THE CHAMBER IS UNABLE TO TAKE A POSITION ON THE DIVIDEND DISTRIBUTION CONCEPT
AS IT IS GOING TO THE SUPREME COURT, BUT IF THE DECISION DOES NOT ALLOW
THE DISTRIBUTION, THE CHAMBER SUPPORTS THE CONCEPT ^{OF} THE MONEY BEING USED
IN INFRA-STRUCTURE, NOT CASH DIVIDENDS.

THE CHAMBER IS CONCERNED ^{THAT} ~~THAT~~ THE PERMANENT FUND MAY BECOME A LARGE
CAPITAL POOL AND MANAGED BY THE TRUSTEES WITH LITTLE BENEFIT TO THE
RESIDENTS OF ALASKA, AND URGE THAT THE MAXIMUM USE BE MADE TO BENEFIT
ALASKA AND ITS ECONOMY.

OF COUNSEL
M. E. MONAGLE

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October 23, 1981

Senator Vic Fischer
221 East 7th Avenue, # 204
Anchorage, AK 99501

Dear Senator Fischer:


At the Permanent Fund Hearing on October 21, you asked for examples of instances where the Permanent Fund might be used to compete unfairly with the private sector. Rather than hypothesize a list of possible illustrations, permit me to answer by drawing to your attention a recent instance of just that kind of interference by the State with the operation of the free market.

When the Kenai Fish Processing Company ran into financial problems, AARC took over direct ownership of the plant and proceeded to compete with other private sector fish purchasing and processing operations in the Kenai area. This incident resulted in one business having an easier economic burden than all others operating in the same business at the same place and time. We regard this as unfair.

We do not feel that it would be possible to provide the Committee with a specific road map as to which investments can and cannot be fairly made from the Permanent Fund, but we strongly urge that as a matter of policy the impact of any investment on the competing businesses in the same market be weighed when attempting to decide whether the investment properly responds to the mandate that the oil wealth of the State be dedicated to the benefit of all Alaskans equitably.

I hope that these comments are helpful. If I may be of further assistance in this regard, please do not hesitate to call on me.

Very truly yours,


J. P. Tangen, Vice Chairman
Alaska State Chamber of Commerce

JPT/mks
cc: The Permanent Fund Committee

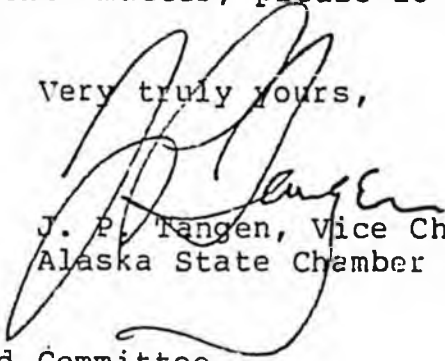
ROBERTSON, MONAGLE, EASTAUGH & BRADLEY

Senator Arliss Sturgulewski
Representative Samuel R. Cotten
October 23, 1981
Page Two

many of our members benefit directly from such loans, and therefore, do not take a formal position on this question. It is the position of the Chamber, however, that if the legislature chooses to make such subsidized loans, the subsidized aspect of the program be made clear to all and that this subsidy be made as a matter of policy determined by the State to be in the public interest.

I hope these comments are helpful. If I may be of further assistance in this matter, please do not hesitate to call on me.

Very truly yours,



J. P. Tangen, Vice Chairman
Alaska State Chamber of Commerce

JPT/mks
cc: The Permanent Fund Committee

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October 23, 1981

Senator Arliss Sturgulewski
2957 Sheldon Jackson
Anchorage, AK 99504

Representative Samuel R. Cotten
P. O. Box 296
Eagle River, AK 99577

Dear Senator Sturgulewski and Representative Cotten:

At the Permanent Fund Hearing on October 21, you inquired as to the position of the Alaska State Chamber of Commerce on subsidized loan programs. I fear that my answer may have been incomplete and possibly misleading and request this opportunity to clarify our position.

First, our comments are directed solely at the dedication of Permanent Fund resources. We are opposed to the Permanent Fund making any subsidized loans whatsoever, because we believe that such programs do not adequately safeguard the Fund and do not permit it to grow as it would with more prudent investments. Furthermore, we believe that such loans benefit the borrower primarily, which, in turn, results in an inequity toward non-borrowers. Even conceding that the increased economic activity which may come about because of such a loan program, it still remains the case that only a small group of Alaskans benefit from money that should be used for the good of all Alaskans.

Second, with regard to subsidized loan programs supported by appropriations from the General Fund, we note that

Interior Mortgage & Housing Association, Inc.

P.O. Box 168 • Fairbanks, Alaska 99707

October 22, 1981

My name is Evelyn Campbell and I am President of Interior Mortgage and Housing Association, Inc. of Fairbanks. Our group consists of all facets of the housing industry, from Realtors and lenders to contractors and appraisers.

We have seen the position paper published by the Alaska Board of Realtors and we, too, want to see the Permanent Fund as a legacy for future generations of Alaskans. However, we would like to see some of the income from its investments used for productive investments which provide benefits for the present.

Two items we see as imperative are safety for the fund and diversified investments.

As mentioned in Elmer Rasmuson's memorandum of September 10, 1981 to the Trustees of the Permanent Fund, a portion of the Fund could be used in housing as a means of benefitting a large cross section of Alaskans.

We would like to see some of the income from the Fund invested in the Alaska Housing Finance Corporation. AHFC now has a AA bond rating, which, it has always been said, had to be a prerequisite before the Permanent Fund could purchase their bonds.

The advantages we see for AHFC include better stability for the program and a safer risk for a typical investor if a portion of the issue were purchased directly by the Permanent Fund.

Using some of the income produced by the Fund would make it more acceptable to Alaskans since a great number could derive direct benefit by being able to purchase a home below market rates. Hopefully this would encourage an increasingly better lifestyle for everyone.

Investing in AHFC would allow more diversification for the fund in case short term markets falter. Thirty year bonds with a ten year amortization should be acceptable to AHFC and they could feasibly become a self-perpetuating entity. It is estimated that the typical mortgage loan in Alaska pays off in approximately five years because of the transient population.

There is investment potential within this state whereby these long-term bonds could have a direct effect on residents being able to invest in real estate, which puts capital into the economy and has the multiplier effect. It is said that for every \$1 invested in the base industry, \$4 goes into the private sector, which helps promote continued, steady growth for the State.

AHFC is rated as one of the best State loan programs in the nation. It is not without problems; however, and needs work to make it a stable, long-range program beneficial to a wide cross-section of Alaskans each year.

Each fiscal year the housing industry must wait to see what the Legislature will do in the way of funding to AHFC. Since the Fiscal Year end falls during the height of the construction season around the State it causes hardships to everyone involved in planning construction for that summer. Housing shortages have arisen because contractors and lenders are unable to plan ahead without knowing if funds will be available to pay off construction loans.

AHFC projects their program will reach \$1.2 billion in volume in 1982. So far this year over 1000 families have benefitted from its financing in Fairbanks alone.

Alaska Housing Finance Corporation can offer suggestions for ironing out the mechanics necessary for realizing the greatest potential by using some of the income from the Fund to keep this very beneficial program going.

Currently AHFC is going Outside on the national level to raise money on the Bond Market, paying 19-1/8% and yet we have a Permanent Fund investing Outside with a yield at approximately 14 1/2%. We feel the advantages from that Fund should be given to Alaskans and yet be a sound investment. We think investing in Alaska Housing Finance Corporation is a way to do that. The AHFC Board would probably be more than willing to accept direct investment or bond purchases.

We of Interior Mortgage and Housing Association offer our services in compiling data and statistics or in giving suggestions in any way possible.

Thank you for allowing us to be on your schedule today.



REALTOR[®]

ALASKA ASSOCIATION OF REALTORS[™]

1818 W. Northern Lights Blvd., Suite 104 • Anchorage, Alaska 99503
Telephone 907-272-8016

October 20, 1981

Board of Trustees
Alaska Permanent Fund Corporation
Anchorage, Alaska 99501

Gentlemen:

Enclosed herewith are copies of two Position Papers from our Association concerning recommendations for investment of the Permanent Fund. Due to the fact that I have a previous commitment on behalf of our Association, I have asked Mr. Kenneth Jay Gain, one of our past Presidents and the principal author of the Position Papers, to make the presentation of our Position Papers to you at your meeting on October 22nd.

As you can see from examination of the attached Position Papers, the Alaska Association of Realtors totally supports the concept of the Permanent Fund as well as an investment program which will protect it from erosion in value through inflation. Although we recognize the importance of diversification in the management of "trust type investments", we believe that a substantial portion of Permanent Fund assets should be invested in housing mortgages in Alaska. By adopting our recommended "2% Solution", the Permanent Fund will receive a reasonable return on money invested, provide for immediate benefit of Alaska's citizens and its economy, and satisfy the need to "Alaskanize the Permanent Fund".

Thank you in advance for your consideration. If you would like to meet with myself or other members of our Association in formulating the final investment strategy of the Permanent Fund, please feel free to call on me.

Sincerely,

ALASKA ASSOCIATION OF REALTORS

Bruce E. Winton
President

Enclosures

KJG:lbk



At the current time, the interest cost to borrowers would be approximately 13% (10% + 3%). Although this rate is greater than the financial capacities of many families, these families would still have the opportunity of availing themselves of the State Assisted Mortgage Program administered by the Alaska Housing Finance Corporation. As discussed in our earlier paper, there are still many unmet housing needs under existing programs. Loans from the Permanent Fund could fill this gap.

To eliminate the need for establishment of a new bureaucracy, this program could be easily administered through purchase of qualified loans originated and serviced by the State's existing financial institutions.

Although it is possible that our recommended program can be implemented immediately without the need for change in legislation, we will support changes in the law governing the investment policies of the Permanent Fund to specifically authorize investment of a reasonable share of the total assets of the Permanent Fund in such mortgages.

The advantages of our recommendation for investment of the Permanent Fund over other recommendations are as follows:

1. The purchasing power of the principal in the Permanent Fund will be protected from erosion in value due to inflation.
2. The investments in mortgages will always yield a positive 2% return which can be utilized for dividend programs or other purposes.
3. The immediate investment of a significant portion of the Permanent Fund in Alaska will provide immediate benefits for the citizens of Alaska and help to expand the economy, tax base, and tangible wealth of the State.
4. Our plan is quite simple and can be easily understood by most Alaskans.
5. Our plan is ultimately fair in that borrowers will pay an interest rate on their mortgages equal to the historical cost of such long-term mortgages, therefore, those citizens of Alaska who do not choose to borrow from the Permanent Fund will not see their share of the money used to subsidize others.
6. Since our plan specifies that only a portion of the Permanent Fund's assets be invested in this program, there still remains the opportunity to apply the "prudent man rule" to diversification of the investments.

7. A major advantage of our proposal is that it provides a rational compromise to the political issues now facing the Alaska Permanent Fund.

In summary, it is the belief of our Association that if our recommendation is adopted, the Trustees will be complying with the original mandate of the people of Alaska when they established the Permanent Fund as well as providing current benefits to the citizens of the State while at the same time expanding our wealth, tax and economic base. The Alaska Association of Realtors, therefore, urge that you "Alaskanize the Permanent Fund" by adoption of the "2% Solution".

POSITION PAPER OF THE
ALASKA ASSOCIATION OF REALTORS
IN REGARD TO THE
ALASKA PERMANENT FUND

It is the belief of the Alaska Association of Realtors that the Alaska Permanent Fund, if properly administered and invested, will be one of the greatest legacies that this generation of Alaskans can leave to Alaskans of the future. Our perception of the Permanent Fund is a fund in which we deposit savings from our current income to be invested to provide future benefits. As is true in most personal lives, we anticipate that there will be a time when income of the State of Alaska declines. At that time, resources of the Permanent Fund can be tapped to provide continuation of an acceptable life style.

Since we believe that there are some similarities in philosophy between the Permanent Fund and an individual saving for his own future, we believe that an examination of the philosophies of those who are successful in their personal lives, and those who are not, may provide some guidance for the philosophy of the Fund.

The first criteria for a successful savings/investment program is to be certain that all income is not used for today's consumption. By law, the people of Alaska have provided that some of today's income will be saved in the Permanent Fund and the last two sessions of the Alaska Legislature have made additional contributions to that Fund. To that extent, the current approach to the Permanent Fund has successfully completed the first step essential to a successful savings/investment program.

The next step in a successful savings/investment program is to invest money saved at rates that will grow faster than the rate of inflation and, therefore, grow in real value. As all financially astute people are now aware, a mere savings account which earns interest at rates less than the inflation rate will decrease in real value and will ultimately result in financial failure. An examination of the reported financial returns on the Permanent Fund indicate that, to date, it has earned a return greater than the rate of inflation.

A truly successful savings/investment program is one in which the first two steps are followed but, in addition, one in which investments are made in a manner that can provide some current benefits and a foundation for accumulation of real wealth. The common denominator between all persons who have accumulated real wealth is the fact that they invested a major portion of their savings in productive investments